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OVERSIGHT OF PRIVATE PENSION PLANS, 1983

HEARINGS

BEFORE THE

SUBCOMMITTEE ON LABOR

OF THE

COMMITTEE ON
LABOR AND HUMAN RESOURCES
UNITED STATES SENATE

NINETY-EIGHTH CONGRESS

FIRST SESSION

ON

OVERSIGHT ON THE CURRENT HEALTH AND FUTURE PROSPECTS FOR DEFINED BENEFIT PENSION PLANS

MARCH 21 AND MAY 24, 1983

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OVERSIGHT OF PRIVATE PENSION PLANS, 1983

MONDAY, MARCH 21, 1983

U.S. SENATE,
SUBCOMMITTEE ON LABOR,
COMMITTEE ON LABOR AND HUMAN RESOURCES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9:35 a.m., in room SD-562, Dirksen Senate Office Building, Senator Don Nickles (chairman of the subcommittee) presiding.

Present: Senator Nickles.

OPENING STATEMENT OF SENATOR NICKLES

Senator NICKLES. Good morning. The hearing today is very timely, in my opinion, coming in the wake of congressional consideration of the social security restoration bill.

The social security program is only one part of our society's retirement system. Part of this subcommittee's responsibility is oversight of another vital part of our retirement system, private pensions.

It is this subcommittee's intention to begin a thorough review of the health and future prospects of the private pension system. The entire retirement picture for today's workers, who are also tomorrow's retirees, needs to be analyzed to determine its weaknesses and its strengths; I believe it has both.

At the present time, all the statistics point to a growing and maturing system. As the recent congressional debates indicate, there are inherent limitations in the social security component of the pension system. Private pensions, on the other hand, do not suffer from the pay as you go problems of the social security system.

Almost 10 years ago, Congress passed the Employee Retirement Income Security Act, known as ERISA, a complicated statute that mandated vesting schedules, minimum funding requirements, more complete disclosure to participants, and the controversial title IV insurance provisions. Has this statute had its intended effect? What is the state of the private pension system, and what is its future?

These hearings are intended to answer these critical questions. I want to thank the persons that are scheduled to appear before this committee for their concern about the private pension system and for providing their very important expertise in helping to improve it.

It is also my intention to issue a comprehensive report on the health of the private pension system. We welcome those experts who are before the committee today.

Our first guest is Dallas Salisbury, who is executive director of the Employee Benefit Research Institute. I might also mention to Mr. Salisbury and the other panelists that I have read your statements, and all of these statements will be entered into the record in full.

I would appreciate, especially looking at the length of some of these statements, if you might summarize and then I could ask you a few questions. Please proceed.

STATEMENT OF DALLAS L. SALISBURY, EXECUTIVE DIRECTOR, EMPLOYEE BENEFIT RESEARCH INSTITUTE, WASHINGTON, D.C.

Mr. **Salisbury**. Mr. Chairman, it is a pleasure to be here this morning.

The retirement system, as you noted, is a complex and multifaceted system. The United States has quite successfully built a balanced retirement income system over the last 80 years from both public and private sources. That system has dramatically improved the economic well-being of the Nation's elderly.

Private employer-sponsored defined benefit pension plans, the subject of this hearing, and social security are unique parts of that system due to their emphasis on the orderly retirement of older workers, provision of lifetime benefits, and preplanned wealth accumulation over the worker's full career.

All available data indicates that the private employer-sponsored pension components of the system are in strong condition. When ERISA was passed in 1974, there were approximately 425,000 plans. By late 1982, there were over 745,000 plans. This is an increase of 75 percent in the total size of the pension universe over the prior 8 years, as compared to a 219-percent increase during the 8 years immediately prior to ERISA, indicating growth of the system, but indicating a significant slowdown in growth since ERISA's passage.

Of this universe of plans, approximately 200,000 are defined benefit, the remainder defined contribution. Pre-ERISA, on an annualized basis, approximately 55 percent of new plans created were defined benefit plans. Since ERISA, that percentage has dropped to approximately 24 percent on an annual basis.

As you know, defined benefit plans provide a clearly stated retirement benefit with a fluctuating annual contribution and with the risk of poor investment performance resting with the employer sponsor.

Defined contribution plans, on the other hand, provide no clearly stated retirement benefit, a defined annual contribution, and the risk of poor investment performance generally resides with the employee.

Employer pensions covered over 73 percent of full-time, nonagricultural workers in 1979 working full time, between the ages of 25 and 64—the ERISA participation age. Just over 68 percent of these persons were active participants in plans, with 69 percent in defined benefit pension plans and 31 percent in the remaining defined contribution plans.

With the aging of the baby boom generation and the creation of nearly 300,000 new plans over the past 5 years, it is our belief that coverage and participation are continuing to grow. Some predict otherwise and some believe otherwise.

As a result of that controversy over the future of private plans, the Employee Benefit Research Institute and the U.S. Department of Health and Human Services have committed half a million dollars to the Census Bureau for a current population survey to be conducted in May of this year to establish, on an updated basis from 1979, the true status of the American pension system.

Employer pensions have also grown significantly in their delivery of benefits. In 1950, 450,000 retirees received private employer pension income. By 1979, the census reported 8.7 million. This represented 42 percent of all family units age 65 to 69.

EBRI and Government research studies projecting into the future indicate that based on pensions now in existence, 65 percent of this group will receive pensions by 1995. These numbers, in fact, understate the value of pensions to the elderly population because Government data does not count lump sum distributions from defined contribution pension plans in their recording of income provided by those plans.

The employer-sponsored pension svstem is able to provide benefits because of its financial strength. Assets have grown from $50 billion in 1950 to over $624 billion in late 1982. These advance-funded programs make a significant contribution as well to national savings.

Pension reserves in 1950 represented 12 percent of total savings and represented over 30 percent of total savings by 1980. Research indicates, in fact, that each dollar contributed to a pension represents a net addition to private savings of between $1.35 and $1.85, representing a net addition to savings in 1980 of between $20 and $48 billion that would not have occurred in the absence of tax incentives for private employer-sponsored pensions.

These advance-funded programs also are economically efficient with regard to the Federal budget. Analysts have frequently focused upon the tax expenditure attributable to pensions, a concept that bas become increasingly popular in Congress as budget deficits have grown.

In the fiscal year 1983 budget, for the first time so-called outlay equivalents were also included—the direct budget outlay that would be required to accomplish the same social good.

For employer-sponsored pensions, the gain for the taxpayer in the savings between these tax expenditures and the outlays totaled $63 billion for fiscal years 1982, 1983, and 1984.

Private employer-sponsored pension plans are strong. Defined benefit plans are most prominent, providing known benefits with little employee risk. Past legislative change, however, has encouraged the development of defined contribution plans while generally discouraging, since 1974, further growth of defined benefit plans.

This has largely resulted because changes in the law that treat all plans the same actually create bias. For example, TEFRA established top-heavy provisions for all plans with a significant speedup in vesting. Faster vesting in defined contribution plans can be relatively inexpensive and can produce value.

In defined benefit plans, however, research indicates that it produces little benefit value but significantly higher expense.

Economic and legislative uncertainty make employers weary of taking on indeterminable obligations. Of all pension programs, defined benefit plans are the most indeterminable in terms of employer cost.

One need only explore the history of social security over the last 30 years and the actual cost versus what was expected to understand this distinct risk for the employer inherent in defined benefit plans.

Because employer risks are accentuated, if you will, by economic and legislative uncertainty, the number of legislative proposals currently pending before the Congress continues to create an environment in which employers are leery of taking on these risks through defined benefit plan formation.

Proposed changes in minimum standards, the tax treatment of plans, the plan termination guarantee program, and social security, join together to have an adverse impact. The growth of individual retirement accounts also promises to complicate the environment, as decisions are forced on employer versus individual provision.

As the Congress considers changes in retirement income programs, it must act with great care if the Nation is to avoid unintended but irreparable harm.

The differences between what can be achieved with defined benefit and defined contribution plans must be considered.

The differences between the stability of employer provision and the risk of individual provision must also be recognized.

The differences in the effects of policy changes on different types of plans and the relative prospects of their continuation, given those changes, must be considered.

This committee takes a giant step forward by beginning discussion today of our multifaceted retirement system's strengths, the implications of policy changes on each component, and the retirement income provision implications of nonneutral policies which lead to defined benefit pension plan formation changes.

The Employee Benefit Research Institute stands ready to help this committee and others in evaluating the consequences of proposed policy changes, and very much appreciates the opportunity to have worked with you today.

[The prepared statement of Mr. Salisbury follows:]

EBRI

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A
Statement On

*"The Current Health and Future Prospects for
Defined Benefit Pension Plans"*

By
Dallas L. Salisbury*

Before The

United States Senate
Committee on Labor and Human Resources

Subcommittee on Labor

March 21, 1983

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*The views in this statement are those of the author and do not necessarily reflect the views of the Employee Benefit Research Institute, its Trustees, members, or other staff.

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Summary

The United States has successfully built a balanced retirement income system. That system has dramatically improved the economic well-being of the nation's elderly.

Private employer sponsored defined benefit pensions and Social Security are unique parts of that system due to their emphasis on:

- *the orderly retirement of older workers;*
- *provision of lifetime benefits; and*
- *preplanned wealth accumulation over the worker's full career.*

All available data indicates that the private employer sponsored pension components of the system are in strong condition. When ERISA was passed in 1974 there were approximately 425,000 plans. By late 1982 there were 745,000 plans. This is an increase of 75 percent over eight years as compared to 219 percent in the eight years before ERISA.

Of this universe of plans 192,000 are defined benefit and 545,000 are defined contribution. Pre-ERISA, approximately 55 percent of net new plans each year were defined benefit; post-ERISA, the annual average for defined benefit plans dropped to 24.2 percent.

- *A defined benefit plan provides a clearly stated retirement benefit, with a fluctuating annual contribution, and the risk of poor investment performance resting on the employer sponsor.*

- A defined contribution plan provides no clearly stated retirement benefit; a defined annual contribution, and the risk of poor investment performance generally rests with the employee.

Employer pensions covered 73.3 percent of full-time non-agricultural employees between 25-64 who had been with their employer for more than one year in 1979. Just over 68 percent of these persons were active participants, with 69 percent in defined benefit pension plans and 31 percent in defined contribution pension plans. With the aging of the babyboom generation, and the creation of over 277,000 net new plans over the past five years, it is likely that coverage and participation is growing.

Employer pensions provided benefits to 450,000 retirees in 1950 and 8.7 million retirees in 1979, which represents 42 percent of all family units age 65-69. EBRI and government research indicates receipt by over 65 percent of these households by 1995. These numbers understate the value of pensions since they do not include lump sum distributions from defined contribution plans.

The employer sponsored pension system is able to provide benefits because it is financially strong. Assets have grown from $50 million in 1950 to $624 billion in late 1982. EBRI estimates that $451 billion (72.3 percent) was in defined benefit pensions plans. Well over half of these plans are over 100 percent funded. Each year funded strength has been growing.

These advance funded programs make a significant contribuiton to national savings. Pension reserves represented 12.7 percent of total savings in 1950 and 30.9 percent in 1980. Research indicates that each dollar contributed to a pension represents a net addition to savings of between 35 cents and 85 cents, indicating a net addition to savings in 1980 of between $20 billion and $48 billion that would not have occurred in the absence of pensions.

These advance funded programs also are economically efficient with regard to the federal budget. Analysts have frequently focused upon the "tax expenditure" attributable to pensions. If persons insist on using this questionable concept they should also focus upon "outlay equivalents," the direct budget outlay required to accomplish the same results. For employer sponsored pensions the "gain" for the taxpayer was a total of $63 billion for FY 82, 83 and 84.

Private employer sponsored pensions are strong. Defined benefit plans are most prominent, providing known benefits with little employee risk. Past legislative change has encouraged development of defined contribution plans and discouraged defined benefit plans. This has largely resulted because changes in the law that treat all plans the same actually create bias. For example, TEFRA established "top heavy" provisions for all plans with a significant speedup in vesting. Faster vesting in defined contribution plans can produce value. In defined benefit plans, however, research indicates that it produces little benefit value but significantly higher expense.

Economic and legislative uncertainty make employers wary of taking on indeterminable obligations. Of all pension programs, defined benefit plans are the most indeterminable in terms of employer cost because the employer bears the risk of poor investment performance and retrospective legislative changes. Consider, for example, experience with Social Security actual costs versus projected costs.

The full range of legislative proposals now under consideration that would affect pensions act as impediments to employer pension plan growth in general, and defined benefit plan growth in particular. Proposed changes in minimum standards, tax treatment, the plan termination guaranty program and Social Security join together to have an adverse impact. Ultimately, it is the nations retirees who will feel these adverse effects.

The growth of IRAs also promises to complicate the environment as decisions are forced on employer versus individual provision.

As the Congress considers changes in retirement income programs, it must act with great care if the nation is to avoid unintended but irreparable harm.

- The differences between what can be achieved with defined benefit and defined contribution plans must be understood.
- The differences between the stability of employer provision and the risks of individual provision must be understood.
- The differences in the effects of policy changes on different types of plans, and the relative prospects of their continuation, given changes, must be understood.

Conclusion

The Employee Benefit Research Institute stands ready to be of assistance in evaluating the consequences of proposed policy changes. Additionally, we will work to expand knowledge of employee benefit programs through projects such as the census bureau survey.

It has been a pleasure to appear before you today and to be a part of this discussion of the American retirement income system.

This Committee takes a giant step forward by beginning discussion today of our multi-faceted retirement system's strengths, the implications of policy change on each component, and the retirement income provision implications of "non-neutral" policies which lead to fewer defined benefit pension plans.

STATEMENT

Introduction

Mr. Chairman. It is a pleasure to appear before you today to review the status of the American retirement income system. This nation has been successful in building a balanced system that has dramatically improved the economic well-being of the nation's elderly. If nurtured, the system will continue to do so in the future.

I appear today in my capacity as Executive Director of the Employee Benefit Research Institute, a non-profit, non-partisan public policy research organization founded in 1978. EBRI sponsors research and educational programs to provide a sound basis for legislative and regulatory decisions. EBRI as an institution does not take positions on public policy issues. Prior to joining EBRI I served as Assistant Executive Director of Policy at the Pension Benefit Guaranty Corporation and Assistant Administrator for Policy, Planning and Research at the U.S. Department of Labor's Pension and Welfare Benefit Program.

THE RETIREMENT INCOME SYSTEM 1/

Social Security has grown to be the primary source of retirement income in this nation, having become a mature program which provides benefits to over 92 percent of retiree households. Private employer sponsored defined benefit pensions and Social Security are unique parts of the retirement income system due to their emphasis on:

- the orderly retirement of workers;
- provision of lifetime benefits to enhance economic dignity; and
- preplanned wealth accumulation over the workers' full careers

All available data indicates that the private employer sponsored pension components of the system are in sound financial health, judged against the laws in effect today and the criteria of meeting benefit promises.

Other components of the system that add to economic security of the elderly include:

- life insurance and health insurance;
- Medicare, Medicaid and Supplemental Security Income;
- personal savings and home equity;
- senior citizens discounts, in-kind benefits and food stamps; and
- family transfers and income from employment

Over 95 percent of all retirees receive economic value from these sources, making their inclusion in analyses of retirement well-being essential.

The Private Employer Sponsored Pension Universe

The first non-governmental private defined benefit pension program in the United States was established in 1875 by the American Express Company. When the Employee Retirement Income Security Act of 1974, popularly known as ERISA, was passed there were approximately 425,000 employer sponsored pension plans. By September 30, 1982, Internal Revenue Service records indicate that approximately 745,000 employer plans were in operation (Table 1). This represents a 75 percent increase in the number of pension plans sponsored by employers during this eight year period, the slowest annual growth rate in history (Table 2). During the prior eight year period (1966-1974), the total number of plans increased by 219 percent. Looking behind this number may provide an understanding of the influence of ERISA.

The universe of approximately 745,000 private employer-sponsored plans is made up of approximately 192,000 defined benefit plans and over 545,000 defined contribution plans (Table 3). Defined benefit plans are 98 percent single employer and 2 percent multiemployer. Employer sponsored defined contribution plans are 99.9 percent single employer and .1 percent multiemployer. The multiemployer defined benefit plan universe consists of approximately 2,600 plans.

What all defined benefit and all defined contribution plans do, and the risks they create, are distinctly different (this applies to employer sponsored plans as well as Individual Retirement Accounts and plans for the self-employed).

- The defined benefit plan, provides a clearly stated retirement benefit which can be adjusted for inflation.
- The defined contribution plan, provides a clearly stated retirement plan contribution.
- In the defined benefit plan, the contribution is aggregated, is worked out over time, and is generally indeterminable before retirement for a specific employee.
- In the defined contribution plan, the contribution is made on a per employee basis and is allocated to individual accounts.
- In the defined benefit plan, the risk of poor investment performance is borne by the employer.

- *In the defined contribution plan, the risk of poor investment performance is borne by the individual.*
- *A defined benefit plan can be both prospective and retrospective in order to accommodate older workers.*
- *A defined contribution plan can be prospective only, necessitating a long period of contributions.*

Each type of employer pension program has been in existence since the early 1900's. The largest defined contribution program was created in 1918 for educators, the Teachers Insurance and Annuity Association (TIAA). This money purchase type plan provides for specific contributions which are used to purchase a pension annuity upon retirement.

Most defined contribution programs are of the profit sharing type, thus contributions fluctuate with profitability of the firm. During the 1970's and 1980's there has also been growth of tax sheltered annuities, Keogh (HR-10) plans for the self-employed, target benefit plans, individual retirement accounts (IRAs), thrift-savings plans, employee stock ownership plans (ESOPs), and salary reduction or 401(k) plans.

Before the passage of ERISA 27 percent of all employer sponsored pension plans were defined benefit, with 73 percent of all employer pension plan participants. The period since 1974 has been marked by inconsistency and instability.

The defined benefit plan proportion of all net new employer plans created between 1956 and 1974 was approximately 55 percent. For the *period 1975 to 1982, the defined benefit proportion averaged 24.2 percent. This is a 56 percent reduction in the historical proportion of net new plans that are defined benefit.*

Pension Plan Growth by Type of Plan 1/

Years	*Percent Defined Benefit*	*Percent Defined Contribution*
1956-1966	*54.4*	*45.6*
1967-1974	*55.3*	*44.7*
1975-1982	*24.2*	*75.8*
1979-1982	*28.5*	*71.5*
1982	*32.5*	*67.5*

Source: EBRI Tabulation from Table 4
1/ 1982 is for 1/1/82

In 1976, the number of defined benefit plans actually dropped, with 100 percent of net new plans being defined contribution (Tables 4 and 5).

In 1977, only eight percent of net new plans were defined benefit; in 1978, 10 percent; in 1980, 26 percent; and in 1981, 28 percent; during the first nine months of 1982, 40 percent.

The unsettling nature of the major legislative change represented by ERISA is clearly shown by these numbers, with the rate of net new employer plan creations dropping to an annual average rate of less than eight percent, about one-half the historical pre-1975 rate. In the presence of ERISA, however, the size of the private pension universe has grown significantly.

ERISA had the clear and immediate result of retarding the development of employer sponsored pensions. That result was most severe for defined benefit pension plans. In the absence of major policy and economic change, this trend can be expected to continue.

Four points will significantly influence development of the pension system in the future: First, the restructuring of our economy now taking place; second, proposed changes in the plan termination insurance programs; third, proposed changes in the tax treatment of pensions and the minimum standards they must meet for tax qualification; and fourth, the development of Individual Retirement Accounts. Before turning to these issues, however, further exploration of the current status of pensions is desirable.

Plan Coverage and Benefit Receipt 2/

The most recent data available on the scope of pensions was collected in 1979 by the U.S. Bureau of the Census. The survey indicated that 54.8 percent of all civilian workers were covered by a pension, i.e., they would begin earning credit toward a benefit if they remained with their employer. Just under 46 percent were participants in plans, i.e., they were earning credit toward a benefit. This compares to 9.1 percent participating in 1940, 15.5 percent in 1950, and 30.6 percent in 1960.

Pensions are not a first priority for new businesses. Pensions, by design, tie benefits to years of service and level of earnings, and recognize that it takes a career to earn meaningful pension benefits. Defined benefit plans can, however, provide for past service credit to produce higher benefits if needed.

Therefore, in recognition of job turnover rates at young ages, among part-time workers, and among casual labor, plans have been designed to cover older, stable, full-time workers. In 1979, for example, 49.7 million of 95.4 million workers were civilian, non-agricultural employees ages 25-64 working more than 1,000 hours per year and with their current employer more than one year.

For pension purposes this can be viewed as the "relevant" workforce: those who could expect to earn a meaningful benefit. Of these workers, 73.3 percent were covered in 1979 and 68.3 percent were active participants in employer sponsored plans. Over 55 percent of participants had a vested right to a benefit.

This means that in 1979, 26.7 percent of the relevant workforce did not have employer pension coverage. The decision of an employer to sponsor a pension plan is related to a number of factors. First, a firm adds benefits only as it ages and grows, with a pension being a late addition. Just over 26 percent of employees in firms of under 25 employees were covered in 1979 as compared to over 91 percent of employees in firms with more than 1,000 employees. The limited data available indicates that firms start a plan as soon as they can afford to, with progressive tax rates making it more advantageous as firms grow.

Second, industry plays a major role in the level of coverage due to (1) plan creation decisions and (2) employee turnover rates. For example, manufacturing, transportation and mining are generally large, have high coverage rates (80-90 percent), and low turnover (15-18 percent). Trade construction enterprises vary in size, have lower coverage rates (55-60 percent), and have high turnover (28-42 percent). Some industries such as finance have shown significant increases in coverage as firms have aged and grown.

Third, union status is also correlated to pension coverage, with over 88.2 percent of union members in the relevant workforce covered as compared to 60 percent of their nonunion counterparts.

There are also employee characteristics related to pension coverage. Low earners, for example, are least likely to have employer pensions. There are several reasons. First, many low earners are part-time workers. Second, many low earners work in small firms where plan sponsorship is least likely. Third, low earners are frequently young and will gain pension coverage as they age. Fourth, low wage earners are generally concerned with current consumption and know that Social Security will provide high final wage replacement.

The noncovered population is relatively concentrated. Characteristics indicate, however, that policy actions would have to be carefully crafted to increase coverage beyond what current plans and demographics will produce. Of relevant workforce respondents to the 1979 CPS:

- *19.2 percent were working for firms with fewer than 25 employees, yet they represented 48 percent of noncovered workers;*
- *firms with less than 100 workers accounted for 31 percent of jobs but 67.1 percent of noncovered jobs;*
- *trade and service employees generate 38.7 percent of jobs, but they account for 58.4 percent of all noncovered employment; and*
- *27 percent had earnings below $10,000; however, this group represents 44.1 percent of all noncovered workers.*

Of all plan participants, approximately 53 percent (28 million) are in single employer defined benefit plans and 16 percent (8.5 million) are in multiemployer defined benefit plans. 30 percent (15.8 million) are in single employer defined contribution plans and one percent (.5 million) in multiemployer defined contribution plans.

With the aging of the baby-boom generation, and the creation of over 277,000 new employer sponsored pension plans over the past five years, it is likely that coverage levels are increasing. To determine the facts on current coverage and participation, EBRI has committed several hundred thousand dollars and contracted with the U.S. Census Bureau to re-survey the nation in May, 1983. This survey will provide a clear picture of the employer pension universe as of early 1983. This will allow a comparison to the system of 1979, as well as serving as an evaluation base for assessing system adjustments in response to TEFRA.

The receipt of pension income is also increasing as the system matures. During 1950, 450,000 retirees received employer pension checks as beneficiaries. During 1979 there were 8.7 million beneficiaries. This represents growth from 13 percent of those receiving Social Security also receiving private pension plan income to over 30 percent, representing over 42 percent of all family units age 65-69. Research conducted by the government and EBRI indicates that the number of beneficiaries is growing each year, with over 65 percent of family units age 65-69 expected to receive private pension benefits in addition to Social Security by 1995. It should be noted, since the government does not effectively count dollars taken from plans in the form of lump-sum distributions, these receipt rates are probably low. And, it should be remembered that only defined benefit plans allow post-retirement inflation adjustments (provided on an ad hoc basis by 85 percent of sponsors).

Judged against a standard of delivering meaningful benefits to a growing number of America's elderly, private employer sponsored retirement income programs are playing a major role and represent a major success.

While ERISA and other regulatory actions may have slowed pension growth, the system is none the less strong and growing.

Plan Financial Status 3/

The employer sponsored private pension system is also financially strong. It has shown significant historical asset growth due to: (1) the advance funded nature of defined benefit plans, and (2) the "fully" funded nature of defined contribution plans.

Private employer sponsored pensions held $50 million in assets in 1920, $5.5 billion in 1950, and $42 billion in 1961. Securities and Exchange Commission data placed private employer plan assets at the end of 1981 at $520.2 billion. While data for 1982 is not available, EBRI estimates that private employer plan assets exceeded $624 billion at year-end. EBRI estimates that $396 billion (63.7 percent) was in single employer defined benefit plans, $55.1 billion (8.6 percent) in multiemployer defined benefit plans, and $173 billion (27.7 percent) in employer sponsored defined contribution plans (Table 6). Both the Securities and Exchange Commission and the ERISA agencies have stopped developing and publishing statistics on plan assets. EBRI encourages the Committee to find a means to rectify this situation.

The benefit security of defined benefit pension plans is a function of the relationship of asset levels to the benefits promised. By this measure the aggregate of plans are in good health, but there is variance by plan size and type.

- *Large Single-Employer Plans are securely funded. These plans, with over 1,000 participants each, account for over 78 percent of all defined benefit plan participants. On average, this universe of plans was 81 percent funded in 1981, as compared to*

65 percent in 1976. Over 50 percent of large plans were 100 percent funded in 1977, and only 5 percent of large plans had unfunded vested liabilities that exceeded 30 percent of the sponsors' net worth in 1981. Continuing significant plan asset growth justifies an assumption that the situation is even better today. While causation cannot be proven, as plans have matured, their funding has improved.

- Small Single-Employer Plans are even more secure based upon the most recent available studies. Over 65 percent of small plans were 100 percent funded and 81 percent of plans were 75 percent or more funded.
- Multiemployer Plans were generally not as well funded in 1978 as single-employer plans, even though a significant portion were over 75 percent funded. Between 28 and 48 percent were fully funded, between 48 and 70 percent were 75 percent or more funded, and between 80 and 90 percent of these plans were 50 percent or more funded.

Experience of the PBGC indicates that plans are even better funded on a termination basis than these numbers indicate.

Pensions and the Economy

A question that must be asked in evaluating the strength of the pension system is the effective economic value received by the nation at large from the employer sponsored pension system. One indicator is particularly worth noting: advance funded private pensions provide a significant contribution to national savings. As a proportion of total national savings, pension reserves represented 12.7 percent in 1950, 20.3 percent in 1970, and 30.9 percent in 1980. Research indicates that each *dollar contributed to a pension represents a net addition to savings of between 35 cents and 85 cents. This means a savings increase of $1.35 to $1.85 for each dollar contributed, indicating additional savings of between $20 billion and $48 billion in 1980 beyond what would have occurred in the absence of pensions. 4/ Further, if dollars contributed to pensions were instead contributed to Social Security, there would have been an equivalent reduction in national savings.*

Employer pensions also reduce demands upon Social Security and the government. The Budget and Reconciliation Act of 1974 required that the budget contain estimates of "tax subsidies" or "tax expenditures." 5/ These "expenditures" are estimates of the revenue that would be raised if favorable tax treatment were removed and no behavioral change occurred. This last assumption, and the calculation techniques provide reason to question the entire concept. A government decision has been made, however, to base policy decisions upon them. This decision has been made inspite of the fact that the budget notes: "The tax subsidy estimates are not estimates of the increase in Federal receipts that would accompany the repeal of the special tax provisions." The FY 1983 and FY 1984 budgets also contained estimates of "outlay equivalents." This is an estimate of the direct budget outlay that would be required to accomplish the same results as the programs being given special tax treatment. Again, there is reason to question numeric validity. Because credence is placed in these numbers, however, they are interesting to compare.

To the extent that the "outlay equivalent" exceeds the "tax expenditure," one might argue that all taxpayers are benefiting, not just those who take advantage of the special tax treatment (those receiving pension benefits). Current national policy clearly aims to provide people with adequate retirement incomes, indicating that direct budget outlays would be made in the absence of private pensions.

The FY 1984 budget indicates, assuming that the government provided benefits of equal value, that this would have increased FY 82 outlays by $65.8 billion, FY 83 outlays by $70 billion, and FY 84 outlays by $78.8 billion: a total of $214.6 billion over these three fiscal years.

Comparing the "outlay equivalents" to the "tax expenditures", the FY 1984 budget indicates that the existence of private employer sponsored pensions provided the taxpayer a net savings of $63 billion, while simultaneously increasing net private savings by between $52 billion and $126 billion over these three fiscal years. One might label this difference between "tax expenditures" and "outlay equivalents" as an "efficiency gain" for the nation's taxpayers. This would mean a 41 percent efficiency gain from retirement income programs as compared to a 14 percent gain on the aggregate of all other "tax expenditures" when measured against "outlays equivalents" (Table 7 and 8). Additionally, while employer pensions represent the greatest "revenue loss" and the greatest "outlay savings", the Treasury Department reports that nearly 75 percent of the benefit goes to taxpayers earning less that $50,000 per year. This compares, for example, to 5.9 percent of taxpayers under $50,000 who benefit from the exclusion from tax of interest on state and local bonds.

Private retirement income programs make a significant positive contribution to holding down government outlays; through increased savings they strengthen the economy; and through the payment of benefits they increase economic well being.

Plan Benefit Levels 6/

Private employer sponsored defined benefit pension plans, like Social Security, have a clearly specified benefit formula tied to years of service and level of earnings. The ability to determine the benefit to be received helps individuals plan for retirement. The employee can annually review the income that can be expected in retirement by estimating expected salary and the years of service expected under the present plan. The employee can look forward to possible inflation protection through post-retirement adjustments. The employer can also use the plan to manage the size of the workforce in troubled times.

Employers have indicated recognition of these defined benefit plan values through the creation and maintenance of defined benefit plans. Companies such as Sears accepted the value of benefit certainty in the mid-70's after profit sharing assets dropped dramatically with a dramatic drop in the price of Sears stock. The defined benefit plan was essential. It provided the benefit certainty needed by employees to allow retirement.

Repeatedly, the federal government and private employers have accommodated organizational restructuring and economic change by providing retirement incentives through defined benefit plans. And, the military holds that the defined benefit plan is essential to maintenance of a volunteer army.

Employer sponsored defined benefit pension plans may be a crucial instrument for this nation in making the economic and industrial transitions now in progress.

Defined benefit plans have been designed in different ways to meet benefit delivery objectives. Hourly (unit credit) plans define benefits by multiplying a given dollar value times the employee's years of service. This produces a benefit that is not directly related to employee earnings (Table 9). Salaried plans define benefits as a percentage of earnings. This produces a benefit that varies with income level (Table 10).

The Pension Benefit Guaranty Corporation (PBGC) now guarantees benefits upon plan termination of up to approximately $20,000, providing full benefit security to the vast majority of workers.

As noted, however, building a right to pension plan benefits takes time. The effectiveness of pensions can only be judged fairly by what they provide in cases where there is a substantial period of employment with the plan sponsor. The lower an individual's income, the truer this becomes. For this reason, the age at which an employee begins participation in a defined benefit plan is less meaningful than some believe, and a short vesting requirement may not be a guarantee of "meaningful" benefit provision. 7/

For example, a 1980 EBRI study of an IRS proposal for three year vesting indicated that 62 percent of those departing with less than 10 years service would have accumulated vested benefits with a total value of less than $1,000, and an additional 23 percent, a total value of less than $2,000. For these workers, a cost/benefit comparison by the pension plan would lead to a cash payment, having the effect of creating a severance pay plan. Were the cash-out level raised to $3,500, as some in the Senate have proposed, over 97 percent of all terminating employees would receive a cash-out. The same study indicated that moving to three year vesting, while maintaining current benefit formulas, could increase costs by as much as 12 percent. A study for the Carter Commission on Pension Policy found that costs could increase by as much as 30 percent. The alternative to increased cost would be to reduce all benefits promised by the plan.

For "public policy" reasons Congress might wish to require earlier participation or faster vesting for defined benefit pension plans. It should be understood, however, that it would not lead to significant new retirement benefit delivery. Due to cash-outs it could actually reduce total retirement income.

Multiple Plan Sponsorship

Employers and employees have made other adjustments in recognition of the career benefit nature and common ten year vesting schedule of defined benefit pension plans.

That response has been to develop plans which complement defined benefit plans, generally providing a specified contribution and a much faster vesting schedule. The most recent available data indicates that of firms with only one plan, 60 percent have defined benefit plans and 40 percent defined contribution plans. Over 26 percent of all plan sponsors, accounting for over 60 percent of all plan participants, however, provide more than one plan. Of multiple plan firms, 55 percent (14 percent of all firms) sponsor both a defined benefit and a defined contribution plan.

The evidence indicates that multiple plan sponsorship was increasing as a means of more effectively meeting employer and employee needs through

1982. The TEFRA change, reducing the total contributions and benefits allowed for multiple plan sponsors, may cause a slowdown. On the other hand, when combined with lower single plan limits it could also cause many employers to create a second plan. Evaluation time is needed. This trend, and the special attributes of each type of plan, should be considered as policy adjustments are evaluated. As noted above, for example, the relative effect on retirement income provision of alternative participation and vesting standards will differ with plan type.

The Status of Employer Sponsored Private Pensions

The private pension system in the United States is the largest and most successful in the world. As it matures it is providing benefits to a growing proportion of the retired population. EBRI's most recent projections indicate that over 80 percent of retiree households will have income from some component of the total system by the turn of the century in the absence of system disruptions that might result from major policy changes.

The component represented by employer sponsored defined benefit plans deserves and demands thoughtful consideration. Pensions are not a gratuity; they must be earned through service. Contrary to some economists' theories, they are not a pure deferred wage, but more complex and more conditional. For example, were they simply a deferred wage there would be no possible economic justification for post-retirement benefit increases.

The private pension system as a whole is strong today. All evidence indicates that it will remain strong if current policies are maintained, even though they are not neutral. Policy changes could make the system stronger or weaker. Before changes are adopted, the consequences should be evaluated.

Unless the government explicitly decides that it wishes to encourage development of one component of the pension system at the expense of another, its policies should be neutral.

IMPEDIMENTS TO EMPLOYER PENSION PLAN GROWTH

Economic and legislative uncertainty combine to make employers wary of taking on new obligations. When combined with regular regulatory change they may choose to terminate programs. Additionally, when the law makes one type of retirement plan much more expensive and risky to maintain than another, the employer may decide to change plans.

Realization that this nation must function as part of an integrated world economy, with a premium placed on flexibility, makes the fixed cost defined contribution retirement plan most attractive. This relative attractiveness is a function of cost and liability defined by laws over the past 20 years.

Plan Termination Insurance

The PBGC program was established to assure that promised defined benefit pension plan benefits would be paid in the event of plan termination, up to a certain level. The initial premium was modest and the liability upon plan termination was viewed as manageable. For multiemployer defined benefit plans the law changed in 1981, and there is the prospect of additional change during this Congress. For single employer defined benefit plans there is also the prospect of plan *termination program changes during this Congress. The question of appropriate public policy aside, these changes would influence decisions to sponsor or maintain a defined benefit pension plan. For example:*

- *defined benefit plan sponsors have always lived with their own plan liabilities, but, they are now liable for the actions of other companies. This liability is avoided by those who sponsor only a defined contribution plan.*
- *defined benefit plans must pay a flat premium without regard to the funded status of the plan or the stability of the plan sponsor(s). Defined contribution plans pay no such premiums.*
- *defined benefit plan sponsors may find themselves liable for liabilites of a subsidiary sold years in the past, even if the sale price was adjusted for that liability. Defined contribution plans carry no such liability.*
- *the availability of funding waivers increases sponsor flexibility and has traditionally increased employer willingness to maintain a plan. For the PBGC, however, funding waivers may be viewed as increasing program exposure and the potential for premium increases, discouraging plan sponsorship.*

The Regulatory Environment

The relative stability of the regulatory environment for private pension programs influences plan sponsorship decisions. As the statistics indicate, ERISA caused disruption. The impact of TEFRA will not show up in plan termination and creation figures until 1984 and 1985, but it can be expected to create new disruption. Withholding, for example, creates *incentives to move towards defined contribution plans with cash distributions upon retirement. The effects of TEFRA, however, may not be clearly separable from the influences of current uncertainties, For example:*

- *constant modification of reporting and disclosure requirements and forms has driven up administrative costs and encouraged plan terminations.*
- *many sponsors expect that future changes in the plan termination program will be adverse to them and are evaluating whether they should maintain defined benefit programs.*
- *proposals for new joint and survivor option reporting requirements would adversely impact defined benefit plans.*
- *reductions in the participation age being discussed would be especially adverse for defined benefit plans, adding to administrative cost, severance cash-outs, and PBGC premium payments, without significant additions to retirement income.*
- *extension of TEFRA's "top heavy" vesting and minimum benefit requirements would have an especially adverse affect on defined benefit plans. Just the suggestion by some members of Congress that this extension might be desirable is now influencing employer behavior.*

- *because current taxation of contributions to pension plans (and annual investment earnings) has been discussed, sponsors and employees are considering the balance of wage and* non-wage compensation. Also, the special problems for defined benefit plans of "attributing" a portion of contributions to each worker would clearly affect plan maintenance decisions and costs.

Debates over policy in each of these areas should explicitly deal with the defined benefit/defined contribution issue and the implications of change.

Employer Plans vis-a-vis Individual Retirement Accounts

Social Security was created in the wake of the great depression in recognition of the need for "employer sponsored" retirement income provision. Private employer pension growth surged beginning in the 1950's as a means of increasing total compensation without increasing total cash wages. A defined benefit approach was used to allow benefit certainty, recognition of past service, and accompanying employee relations advantages.

Concern over individuals without employer pension coverage led Congress to create Individual Retirement Accounts (IRAs), as part of ERISA, in 1974. At the end of 1981, a total of $25.7 billion was in IRAs. EBRI estimates that as many as 5.2 million IRAs had been established by the end of 1981 (Table 11).

Concern over capital formation, the adequacy of retirement income, and the stability of Social Security, led Congress to extend IRA eligibility to all workers in the Economic Recovery Tax Act of 1981 and to increase the allowable contributions amount. EBRI estimates that in excess of $30 billion was contributed to IRAs in calendar 1982 by as many as 30 million individuals. By the April 15 tax filing deadline for 1982 more workers car be expected to open an IRA.

Individual Retirement Accounts generally place total risk on the individual in making the investment vehicle choice, and in living with the results. Retirement planning, as a result, can take significant swings over time. The stock market, for example, which provided a real rate of return in 1955 of 31.2 percent, produced a real loss in 1974 of 38.7 percent. For those with IRAs between 1976 and 1981, 82 percent of the assets realized a five year average real rate of return of .1 percent, while the remaining 18 percent earned a real return of approximately 8.8 percent.

This vulnerability for the individual is an accepted part of employer sponsored and individual defined contribution programs. It is a characteristic to be explicitly understood and accepted. Advertising and analyses for IRAs present retirement income projections based upon assumed real rates of return of 4% to 12%, requiring us to look behind the numbers.

Very little is now known about why people create IRAs, and whether or not they expect to keep this money in the accounts until retirement. Yet, their existence could affect employee attitudes towards employer plans and legislators' evaluation of the tax treatment of all "retirement" savings programs.

The EBRI-sponsored current population survey to be conducted by the U.S. Census Bureau in May 1983, will provide detailed information on IRAs, allowing analysis of who created these accounts and the degree to which they represent new savings.

Great care must be taken in this evaluation. Defined benefit pension plans carry with them the strongest guarantee of providing retirement income. IRAs can be liquidated, at a price, at any time. Many defined contribution plans provide for lump-sum distributions which, upon receipt, may or may not be used for the purpose of long-term retirement income. The degree to which public policy influences the choice of retirement savings through the individual versus the employer, and through defined benefit or defined contribution plans, will ultimately determine the amount of tax-preferred savings that will be used for meeting America's retirement income adequacy goals.

Social Security

Social Security is a vital source of retirement income. A sound Social Security program that retains public confidence is important to private pensions since a majority of plans have been specifically designed to coordinate with it. Yet, Social Security changes could act as an impediment to private plan development. For example:

- *the higher Social Security payroll taxes rise, the more expensive the total cost of labor becomes and the more difficult it becomes for employers and employees to afford additional retirement savings.*
- *the more restrictive the rules become for integrating private plans with Social Security, the more difficult it becomes to afford and to justify private plans, particularly for small employers.*

- *the broader the FICA tax base becomes, the harder it becomes to provide supplementation. Further, discussion of treating retirement plan contributions as FICA "wages" is influencing employer pension provision decisions and would be impossible to implement equitably in defined benefit plans at any point, or in defined contribution plans during the deferred vesting period.*

THE FUTURE OF PRIVATE PENSIONS

Speculation on the future of pensions is a high risk proposition. Uncertainty with regard to government policy makes it especially difficult since it will be the greatest influence on development of our retirement income system.

Maintenance of current policies with "minor" technical adjustments would most likely produce the greatest system stability. The environment of constant change since 1974 caused the pattern of new plan formation to change, with 24 percent of post-ERISA new plans being defined benefit as compared to 69 percent in the 1967 to 1974 period. In the absence of policy change designed to encourage defined benefit employer plans, this new plan formation trend is likely to continue. Numerous legislative actions since 1974 have been specifically favorable to defined contribution plans. For example:

- *authorization of HR-10 Keogh plans*
- *authorization of Individual Retirement Accounts*

- *authorization of Simplified Employer Pensions*
- *authorization of Employee Stock Ownership Plans*
- *authorization of flexible compensation arrangements with salary reduction components*

To the degree that the legislative and regulatory changes outlined previously continue to be discussed without resolution, defined benefit pension growth and stability will be adversely affected. And, uncertainty creates far more difficulties for defined benefit plans than for defined contribution arrangements.

The Congress has taken repeated actions over the past 30 years to expand the flow of assets to retirement savings. Because defined benefit plans became most pervasive in terms of coverage, the recent initiatives listed above have targeted on expanding defined contribution arrangements.

Now, issues are arising over (1) whether too much capital may be flowing into retirement programs, and (2) whether the system is equitable. These are questions for Congress to answer. They must, however, be explored with great care if the nation is to avoid unintended but irreparable harm to our retirement system.

As we are finding in other areas of domestic policy, expansion is much easier than contraction. When contracting, we run the risk of making the wrong program smaller.

This nation has successfully built a complex and multifaceted public and private retirement income system. That system has greatly reduced poverty among the aged, and promises even greater benefit security in the future. Determination, consistency, and care can assure that the private pension component of the system remains strong, and grows stronger.

Conclusion

The Employee Benefit Research Institute stands ready to be of assistance in evaluating the consequences of proposed policy changes. Additionally, we will work to expand knowledge of employee benefit programs through projects such as the census bureau survey.

It has been a pleasure to appear before you today and to be a part of this discussion of the American retirement income system.

This Committee takes a giant step forward by beginning discussion today of our multi-faceted retirement system's strengths, the implications of policy change on each component, and the retirement income provision implications of "non-neutral" policies which lead to fewer defined benefit pension plans.

TABLE 1

SUMMARY OF QUALIFICATIONS AND TERMINATIONS

Period Ending	Number of Qualification Rulings to Date	Number of Terminations to Date	Net Number of Plans in Effect	Increase in Net Number of Plans Over Previous Period	% Annual Growth
Sept. 30, 1982 5/	884,936	144,963	745,973	56,693	8.2
Dec. 31, 1981	816,924	133,644	689,280	68,095	11.0
Dec. 31, 1980	741,387	120,202	626,185	56,063	9.9
Dec. 31, 1979	672,045	106,923	565,122	46,036	6.9
Dec. 31, 1978	615,168	96,084	519,086	50,398	10.8
Dec. 31, 1977	549,484	80,796	468,686	19,601	4.4
Dec. 31, 1976	514,068	64,981	449,087	3,494	0.8
Dec. 31, 1975	485,944	40,351	445,593	21,931	5.2
Dec. 31, 1974	455,905	32,243	423,662	54,781	14.8
Dec. 31, 1973	396,520	27,639	368,881	55,475	17.7
Dec. 31, 1972	336,915	23,509	313,406	45,815	17.1
Dec. 31, 1971	287,580	19,989	267,591	37,329	16.2
Dec. 31, 1970	246,916	16,654	230,262	30,268	15.1
Dec. 31, 1969	214,342	14,348	199,994	26,346	15.2
Dec. 31, 1968	186,267	12,619	173,648	22,339	14.8
Dec. 31, 1967	162,485	11,176	151,309	19,214	14.5
Dec. 31, 1966	141,964	9,869	132,095	16,973	14.7
Dec. 31, 1965	123,781	8,659	115,122	12,496	12.2
Dec. 31, 1964	110,249	7,623	102,626	10,667	11.6
Dec. 31, 1963	98,541	6,582	91,959	10,250	12.5
Dec. 31, 1962	87,397	5,688	81,709	9,359	12.0
Dec. 31, 1961	77,179	4,829	72,350	8,652	13.5
Dec. 31, 1960	67,792	4,094	63,698	9,399	17.3
Dec. 31, 1959	57,835	3,536	54,299	6,792	14.2
Dec. 31, 1958	50,569	3,062	47,507	6,551	15.9
Dec. 31, 1957	43,615	2,659	40,956	6,074	17.4
Dec. 31, 1956	37,190	2,308	34,882	4,944	16.5
Dec. 31, 1955	31,943	2,005	29,938	1,769(1)	6.3
June 30, 1955	30,046	1,877(2)	28,169(2)	3,290(2)	13.2
June 30, 1954	26,464	1,585	24,879	4,204	20.3
June 30, 1953	22,069	1,394	20,675	3,657	21.5
June 30, 1952	18,289	1,271	17,018	2,347	16.0
June 30, 1951	15,899	1,125	14,671	2,517(3)	20.7
June 30, 1950	13,899	--	--	--	--
June 30, 1949	12,865	711	12,154	896	8.0
June 30, 1948	11,742	484	11,258(4)	1,888	20.1
Aug. 31, 1946	9,370	--	9,370(4)	1,584	20.3
Dec. 31, 1944	7,786	--	7,786(4)	5,830	300.0
Sept. 1, 1942	1,947	--	1,947(4)	1,288	195.0
Dec. 31, 1939	659	--	659(4)	549	--

(1) Six month total
(2) See RR 101.-4
(3) Increase from June 30, 1949 (see RR 101.4)
(4) 28 month period, average 2,507 plans per year
(5) 9 month period, 1/1/82 - 9/30/82

*Does not include plans covering self-employed individuals (Keogh Act plans).

SOURCE: Charles D. Spencer Associates for 1930 to 1975, EBRI tabulations of IRS data for 1976 to 1982.

TABLE 2

PENSION PLAN GROWTH

Year	*Net Total Plans Created*	*Defined Benefit*	*Defined Contribution*	*Total Plans*	*Total Plans % Growth*
1956	*4,944*	*2,983*	*1,961*	*35,503*	*16.2*
1957	*6,044*	*3,347*	*2,727*	*41,577*	*17.1*
1958	*6,551*	*3,659*	*2,892*	*48,128*	*15.8*
1959	*6,792*	*3,554*	*3,238*	*54,920*	*14.1*
1960	*9,399*	*4,711*	*4,688*	*64,319*	*17.1*
1962	*8,652*	*4,545*	*4,107*	*72,971*	*13.5*
1962	*9,359*	*4,712*	*4,647*	*82,330*	*12.8*
1963	*10,250*	*5,399*	*4,851*	*92,480*	*12.4*
1964	*10,667*	*6,072*	*4,595*	*103,247*	*11.5*
1965	*12,496*	*6,983*	*5,513*	*115,743*	*12.1*
1966	*16,973*	*9,521*	*7,452*	*132,716*	*14.7*
1967	*19,214*	*10,690*	*8,524*	*151,930*	*14.5*
1968	*22,339*	*12,224*	*10,115*	*174,269*	*14.7*
1969	*25,905*	*13,824*	*12,522*	*200,174*	*14.9*
1970	*30,268*	*15,370*	*14,898*	*230,442*	*15.1*
1971	*37,329*	*20,888*	*16,441*	*267,771*	*16.2*
1972	*45,815*	*26,520*	*19,295*	*313,586*	*17.1*
1973	*55,475*	*31,608*	*23,868*	*369,061*	*17.7*
1974	*54,601*	*30,002*	*24,599*	*423,662*	*14.8*
1975	*21,931*	*10,769*	*11,162*	*445,593*	*5.2*
1976	*3,494*	*-4,180*	*7,674*	*449,087*	*.8*
1977	*19,601*	*1,616*	*17,985*	*468,688*	*4.4*
1978	*50,398*	*5,103*	*45,295*	*519,086*	*10.8*
1979	*46,036*	*12,488*	*33,548*	*565,122*	*8.9*
1980	*56,063*	*14,552*	*41,511*	*621,185*	*9.9*
1981	*68,095*	*19,253*	*48,842*	*689,280*	*11.0*
1982	*56,693*	*18,451*	*38,242*	*745,873*	*8.2*

SOURCE: EBRI tabulations.

TABLE 3

PENSION PLAN GROWTH 1/
1975-1982

	Defined Benefit			Defined Contribution		
Year	Net Created	Total	Annual Growth %	Net Created	Total	Annual Growth
	10,769	124,766	-	11,162	320,872	-
1976	-4,180	120,586	(3.4)	7,674	328,501	2.4
1977	1,616	122,202	1.2	17,985	346,486	5.5
1978	5,103	127,305	4.0	45,295	391,781	13.1
1979	12,488	139,793	9.8	33,548	425,329	8.6
1980	19,552	154,345	10.4	41,511	466,840	9.8
1981	19,253	173,598	12.5	48,842	516,682	10.5
1982 3/	18,451	192,049	10.6	38,242	544,924	6.9

SOURCE: EBRI Tabulations.

1/ Totals differ from Tables 1 and 2 due to different start points for data series.

2/ 1982 is for 1/1/82 to 9/30/82.

TABLE 4

PENSION PLAN GROWTH BY TYPE OF PLAN

Year	Defined Benefit %	Defined Contribution %
1956	60.3	39.7
1957	55.1	44.9
1958	55.9	44.1
1959	51.3	47.7
1960	50.1	49.9
1961	52.5	47.5
1962	50.3	49.7
1963	52.6	47.4
1964	56.9	43.1
1965	55.9	44.1
1966	56.1	43.9
1967	55.6	44.4
1968	54.7	45.3
1969	53.4	46.6
1970	50.8	49.2
1971	56.0	44.0
1972	57.9	42.1
1973	56.9	43.1
1974	54.9	45.1
1975	49.1	50.9
1976	0	100
1977	8.2	91.8
1978	10.1	89.9
1979	27.1	72.9
1980	26.0	74.0
1981	28.3	71.7
1982	32.5	67.5

SOURCE: EBRI Tabulations.

TABLE 5

CORPORATE AND SELF-EMPLOYED PENSION PLAN CREATIONS, TERMINATIONS AND NET PLAN INCREASES 1/

	Defined Benefit Plans			Defined Contribution Plans			
Year	Plans Qualified	Plans Terminated	Net Plans Created	Plans Qualified	Plans Terminated	Net Plans Created	Net Total Plans Created
1956	3,175	192	2,983	2,072	111	1,961	4,944
1957	3,527	180	3,347	2,898	171	2,727	6,074
1958	3,883	224	3,659	3,071	179	2,892	6,551
1959	3,824	270	3,554	3,442	204	3,238	6,792
1960	5,011	300	4,711	4,946	258	4,688	9,399
1961	4,919	374	4,545	4,468	361	4,107	8,652
1962	5,188	476	4,712	5,030	383	4,647	9,359
1963	5,840	441	5,399	5,304	453	4,851	10,250
1964	6,581	509	6,072	5,127	532	4,595	10,667
1965	7,495	512	6,983	6,037	524	5,513	12,496
1966	10,124	603	9,521	8,059	607	7,453	16,973
1967	11,292	602	10,690	9,229	705	8,524	19,214
1968	12,896	672	12,224	10,886	771	10,115	22,339
1969	14,692	969	13,824	13,383	861	12,522	25,905
1970	16,512	1,142	15,370	16,062	1,164	14,898	30,268
1971	22,493	1,605	20,888	18,171	1,730	16,441	37,329
1972	28,265	1,745	26,520	21,070	1,775	19,295	45,815
1973	33,830	2,222	31,608	25,775	1,908	23,867	55,475
1974	32,579	2,577	30,002	26,806	2,207	24,599	54,601
1975	15,319	4,550	10,769	14,720	3,558	11,162	21,931
1976	4,790	8,970	-4,180	23,334	15,660	7,674	3,494
1977	6,953	5,337	1,616	28,463	10,478	17,985	19,601
1978	9,728	4,625	5,103	55,956	10,661	45,295	50,398
1979	15,755	3,267	12,488	41,122	7,574	33,548	46,036
1980	18,849	4,297	14,552	50,493	8,982	41,511	56,063
1981	23,789	4,536	19,253	51,748	8,906	48,812	68,095
1982*	22,102	3,651	18,451	45,910	7,668	38,242	56,693

*Through September 30, 1982.

TABLE 6

PRIVATE PENSION ASSETS
(millions)

Year	Total	Annual Growth $	Annual Growth %	Defined Contributions	% of Total	Defined Benefits multi.	% of Total	Defined Benefits Single	% of Total
1975 1/	260,000	18,000	8.2	74,000	28.4	22,000	8.5	164,000	63.1
1976 1/	298,400	39,400	15.1	82,200	27.5	25,800	8.6	190,400	63.9
1977 1/	325,100	26,700	8.9	91,500	28.1	28,900	8.8	204,700	63.1
1978 1/	377,200	52,100	16.0	104,500	27.7	32,800	8.6	239,900	63.7
1979 2/	424,000	46,800	12.4	117,500	27.7	36,900	8.6	269,600	63.7
1980 2/	500,000	76,300	18.0	138,600	27.7	43,500	8.6	318,200	63.7
1981 2/	520,200	19,900	3.9	144,000	27.7	45,600	8.6	330,600	63.7
1982 3/	624,200	104,000	19.9	172,700	27.7	55,100	8.6	396,500	63.7

SOURCE: (1) Securities and Exchange Commission and U.S. Department of Labor.
(2) Securities and Exchange Commission with breakout by plan type assuming same distribution as 1978
(3) Pension and Investment Age Survey adjusted for EBRI assumptions.

TABLE 7

TAX EXPENDITURES AND OUTLAY EQUIVALENTS*
($millions)

	Tax Expenditures	Outlay Equivalents	Gain $	Gain %
Employer Pensions	56,560	78,780	22,220	39.3
Other Pensions	4,230	6,480	2,250	53.2
ESOPs	1,375	2,405	1,030	74.8
TOTAL	$62,165	$87,665	$25,500	41.0%

SOURCE: EBRI tabulations from Special Analysis G of the proposed FY 1984 budget.

*The entire concept of tax expenditures and outlay equivalents is subject to question due to the assumptions used, inconsistency of calculation techniques, and imprecision of base data. Because the numbers are so widely used, however, we view this anaylsis as being of interest and worthy of discussion.

TABLE 8

FY 1984 Budget

*TAX EXPENDITURES AND OUTLAY EQUIVALENTS**
($ millions)

	Tax Expenditures	*Outlay Equivalents*	*Gain $*	*Gain %*
Private Retirement Programs	*62,165*	*87,665*	*25,500*	*41.0*
All Other Programs	*218,270*	*250,065*	*31,795*	*14.0*
TOTAL	*280,435*	*337,730*	*57,295*	*20.0*
PPR/AOP	*22.2%*	*26.0%*	*$44.5*	*292.9%*

SOURCE: EBRI Tabulations from Special Analysis G of the proposed FY 1984 budget.

**The entire concept of tax expenditures and outlay equivalents is subject to question due to the assumptions used, inconsistency of calculation techniques, and imprecision of base data. Because the numbers are so widely used, however, we view this anaylsis as being of interest and worthy of discussion.*

TABLE 9

HOW PENSION PLANS WORK - HOURLY PLAN

Before Taxes	EMPLOYEE #1	EMPLOYEE #2
1. final earnings rate	$25,000	$15,000
2. pension benefit: $150/yr x 30 years	$ 4,500	$ 4,500
3. Social Security (primary only; age 65)	8,148	7,212
4. retirement income (2+3) /_/ as % of final earnings (line 1)	$12,648 50.6%	$11,712 78.1%
After Taxes		
5. "net pay" - line 1 less Social Security and federal income taxes (1981 rates)	$19,324	$12,382
6. pension benefit, net of income tax (1981 rates)	$ 4,500	$ 4,500
7. after tax retirement income (3+6) /_/ as % of net pay (line 5)	12,648 65.5%	11,712 94.6%
8. after tax income including Social Security for spouse age 62 /_/ as % of net pay (line 5)	$15,703 81.3%	$14,416 116.4%

SOURCE: TPF&C

TABLE 10

HOW PENSION PLAN WORK - SALARIED PLAN

Before Taxes	EMPLOYEE #1	EMPLOYEE #2
1. final earnings rate	$40,000	$15,000
2. Social Security (primary only; age 65)	$ 8,148	$ 7,212
3. pension benefit: 50% of final 5-yr. avg. earnings, less 50% of Social Security	12,885	2,862
4. retirement income (2+3)	$21,033	$10,074
/_/ as % of final earnings (line 1)	52.6%	67.2%
After Taxes		
5. "net pay" - line less Social Security and federal income taxes (1981 rates)	$28,765	$12,382
6. pension benefit, net of income tax	$11,858	2,862
7. aftertax retirement income (2+6)	20,006	10,074
/_/ as % of net pay (line 5)	69.5%	81.4%
8. aftertax income including Social Security for spouse age 62	$23,061	$12,778
/_/ as % of net pay (line 5)	80.2%	103.2%

SOURCE: TPF&C

TABLE 11

INDIVIDUAL RETIREMENT ACCOUNTS

Financial Institution	*Contributions (billions)*		*Assets (billions)*		*Number of IRAs (millions at $1000)*	
	1981	*1982*	*1981*	*1982*	*1981*	*1982*
Commercial Banks 1/	*1.3*	*11.1*	*7.0*	*18.1*	*1.3*	*11.1*
Mutual Savings Banks 1/	*.7*	*2.9*	*3.4*	*6.3*	*.7*	*2.9*
Savings & Loans 1/	*1.1*	*12.5*	*9.2 2/*	*21.7 2/*	*1.1*	*12.5*
Mutual Funds	*1.8*	*2.4*	*2.6*	*5.0 3/*	*1.8*	*2.4*
Credit Unions	*NA*	*.3*	*.2*	*.5 4/*	*NA*	*.3*
Life Insurance Co.	*.3*	*1.3*	*3.3*	*4.6 5/*	*.3*	*1.3*
Total	*$5.2*	*$30.5*	*$25.7*	*$56.2 6/*	*5.2*	*30.5*

SOURCES: EBRI tabulations of data provided by Federal Reserve Board, National Association of Mutual Savings Banks, National Credit Union Administration, Federal Home Loan Bank Board, U.S. League of Savings Associations, Investment Company Institute and American Council of Life Insurance.

1/ IRA and Keogh deposits.
2/ Estimated by EBRI from 4/30/82.
3/ Assumes no growth after 9/30/82.
4/ Assumes no growth after 4/30/82.
5/ Assumes no growth after 6/30/82
6/ Baseline estimates using latest available data for each institution. These estimates provide a minimum total asset amount, which may underreport the actual amount of total assets outstanding.

Endnotes

1/ EBRI would be pleased to make available its published studies in this area which included:

- Retirement Income Programs: Directions for Future Research
- Retirement Income Policy: Considerations for Effective Decision Making
- Retirement Income and the Economy: Policy Directions for the 80s
- Retirement Income and the Economy: Increasing Income for the Aged
- Arranging the Pieces: The Retirement Income Puzzle
- Social Security: Perspectives on Preserving the System

2/ EBRI would be pleased to make available its published studies in this area which include:

- Volume 1: Retirement Income Opportunities in an Aging America: Coverage and Benefit Entitlement
- Volume II: Retirement Income Opportunities in an Aging America: Income Levels and Adequacy

EBRI will update these studies based upon the EBRI sponsored current population survey scheduled for May, 1983.

3/ EBRI would be pleased to make available its published study in this area:

- Volume III: Retirement Income Opportunities in an Aging America: Pensions and the Economy

4/ The savings effect of Social Security and private pensions has been a subject of controversy among economists. Two points of concensus can be identified in a review of the literature. First, pensions have a positive effect of at least 35% ("extremists" say 90%). Secondly, Social Security has no net effect ("extremists" say -50%).

5/ There are critics who question (1) the entire concept of "tax expenditures'; (2) the calculation methods used; (3) and, the assumption that behavior would not change with changes in the tax law. EBRI is considering these issues in a study to be completed in later 1983.

6/ Studies noted above in endnote 1, and endnote 2, contain information on this subject.

7/ EBRI would be pleased to make available its published studies in this area:

- America in Transition: Implications for Employee Benefits
- Economic Survival in Retirement: Which Pension Is For You?

Senator NICKLES. Thank you, Mr. Salisbury.

I went through your comments and some of the charts that you have shown. In looking at the number of defined benefit plans, you show a very strong growth all the way through 1974, and then, actually, a kind of staggering or slowdown to almost nothing, and then we see in the next couple of years 18,000 or 19,000 new plans. That is much smaller, in comparison to the number of defined contribution plans, which have doubled since 1974.

Do you see that trend in moving toward the creation of more defined contribution plans in relationship to defined benefits as positive or negative?

Mr. SALISBURY. I think it is a balance question. Is there a place in our retirement income system for people to have multiple sources of retirement income?

But as the Congress has set up social security, the civil service retirement system, and the military retirement system, they have been consistent; they show a long-term public policy belief that a component of retirement income provision should be from defined benefit pension plans, augmented by other pension plans.

At this point it appears that we have recovered from the immediate jolt of ERISA such that the large number of defined benefit plan terminations has slowed. The numbers indicate that the growth of defined benefit plans is coming back very slightly, but the defined contribution growth is somewhat leveling.

I think in the absence of major legislative change, that will continue and we will see ourselves moving back into a period of an integrated and complementary set of retirement income programs.

The question is really one of what happens if any one of a number of major legislative changes takes place and whether those results will be good or bad. The major factor will be whether those changes have been carefully crafted to give consideration to the differences, and the different needs, of defined benefit and defined contribution programs as compared to just a flat set of policies.

In terms of retirement income provision, I think the main issue is one of risk. In a defined benefit program, with the presence of the plan termination insurance program, there is limited risk on the employee's part in terms of ultimately receiving his retirement income.

As was indicated by Sears, Roebuck in the mid-1970's where, after a history of only providing defined contribution plans to their rank and file employees, they found it necessary to create a defined benefit plan even in the wake of ERISA in order to allow their employees to retire—that tends to speak for itself in terms of the need for an integrated system.

Senator NICKLES. How many plans since the creation of ERISA?

Mr. SALISBURY. The total universe is 750,000 plans. Since ERISA, it is approximately 300,000, I believe.

Senator NICKLES. So, you have actually seen the creation of 300,000 plans since ERISA.

Mr. SALISBURY. Approximately.

Senator NICKLES. Is that net?

Mr. SALISBURY. Net.

Senator NICKLES. You have an increase of 300,000?

Mr. SALISBURY. We have had a 75-percent increase in the total number of plans, which would mean approximately 300,000 plans.

Senator NICKLES. Correct me if I am wrong, but I believe you have a chart on table 5 that shows the number of plans that were created and also terminated.

Do you have any figures to show how many of those are actually coming from, say, industrial-type concerns, or how many are from, say, professional——

Mr. SALISBURY. There is no good data on that, that has yet been tabulated. We are about to undertake a comparison of the 1977, 5,500 filings under ERISA as compared to the 1980 filings, look at which plans have come into existence between those two filings, and look at where those plans come from. We have not yet done that analysis.

Senator NICKLES. Is that part of the money you said you were investing?

Mr. SALISBURY. The Census Bureau survey is a separate survey from the plan determination effort. The Census Bureau survey will provide information on the number of people who are participating in plans, are vested in plans, have created individual retirement accounts, and are covered by salary reduction plans.

They will not indicate when the plan was created or what type of employer they have other than public or private. So, we are going to do a separate study of the 5,500 filings to establish that.

Senator NICKLES. In your opinion, are professional corporations abusing the tax system to take advantage of the deduction, or are business corporations likewise doing that?

Mr. SALISBURY. Well, need is a relative definition, and the law sets maximum limits within which an employer is provided the opportunity to set up a pension plan. The only individuals from the entire pension system who sometimes receive more than 100 percent of what they were earning during their last year of employment in retirement are the lowest income workers. This is due to significant social security income replacement plus some supplementation to that.

The only way to determine abuse, if you will, is to say we do not think anybody should get more than 40, 70, or 80 percent replacement of retirement income, and see whether people, through the way they are allowed to make use of the tax system, are getting those very, very much larger amounts.

I do not think there is good information on whether professional service corporations or others are doing as you say, and I think it is highly judgmental as well.

Senator NICKLES. TEFRA imposed limitations on the amount of either contributions or benefits that could be received. Do you agree in theory with the idea of putting an upward limitation on what would be a legitimate deduction?

Mr. SALISBURY. Well, there should be limits on everything in life. I am not sure where the dollar limit should be. You have a question, in light of cost-of-living increases and other things, of how those limits should be adjusted.

The Institute does not take positions on legislative issues, and even in our research studies we tried to avoid dictating conclusions.

Senator NICKLES. You mentioned possible gains; I heard the figure $63 billion, and that was some figure over and above the tax expenditure. Could you explain that further?

Mr. SALISBURY. In the fiscal year 1983 and fiscal year 1984 budgets, in addition to the so-called tax expenditure numbers, the budget also includes so-called outlay equivalent numbers. The tax expenditure number is, if you were to have no change in behavior among individuals in corporations, how much money is not received by the Treasury because of a certain tax preference?

The outlay equivalent is the amount of money it would take for the Government, through a direct appropriation, to achieve the same results as that tax expenditure. In most tax expenditure items, the outlay equivalent is either less than or equal to the tax expenditure number.

Retirement income programs represent one of the few areas where the outlay equivalent significantly exceeds the tax expenditure, indicating that if you recognize that there is a social purpose for these tax incentives, there is a value gain of this $63 billion over 3 years.

Senator NICKLES. The outlay equivalent would be the amount if the Federal Government was going to provide an equal benefit?

Mr. SALISBURY. If the Government were to provide the same benefits that are being provided by the employer-sponsored pensions, that is the outlay equivalent.

Senator NICKLES. Is that really realistic? I mean, it is not too probable that the Federal Government would do that, at least for upper level amounts.

Mr. SALISBURY. Well, if you look carefully at the way tax expenditure numbers are calculated, it is probably no more unrealistic than the tax expenditure number is.

Senator NICKLES. What do you think of this? What was it, $56 or $57 billion, for tax expenditures?

Mr. SALISBURY. Right.

Senator NICKLES. Do you know how much of an increase that was from the 1983 figures?

Mr. SALISBURY. It was a 75-percent increase from the 1983 figure, and the best explanation we have been able to obtain from the Treasury Department as to why that occurred is that the individual that produced the number in 1982 retired and a new individual came in to do the number.

Senator NICKLES. What is he receiving on his retirement? [Laughter.]

Mr. SALISBURY. The other half of it was that they included for the first time in the employer-sponsored pension number public pension programs in addition to private pension programs. So, whereas up through the fiscal year 1983 budget, that number was purely a number attributable to private employer-sponsored pensions, they have now added public employee pensions into that number.

Senator NICKLES. One additional question.

You mentioned in your statement some of the adverse impacts that could come from policy changes that would be mandated by Congress. You are aware, and I am aware of several pieces of legislation that are floating through.

Can you mention specifically any of those you think might have an adverse impact on the future of the private pension system?

Mr. SALISBURY. Well, two which specifically affect very differently defined contribution plans or defined benefit plans are what you alluded to with the question on TEFRA, which are participation and vesting standards.

In defined benefit plans, because they are basically designed to provide a benefit over a 20- or 30-year period, the amount that can be gained by having someone in them at age 21 versus age 25, studies indicate, is minimal, yet the cost is fairly significant.

What you end up providing are significant severance payments, cash-out benefits when the person leaves of $2,000 or less, rather than a significant retirement income benefit.

Senator NICKLES. You mean significant for a defined benefit plan and not significant for——

Mr. SALISBURY. Well, for defined contribution plans, because of the nature of the plan, where you are putting in a fixed amount each year and it remains constant over the life of the plan, the early year benefit contribution buildup can be more significant than under a defined benefit plan.

Under a defined benefit plan, when you see published figures that say that the average employer cost is 10 percent of payroll. For the 52-year-old worker who just came to work for them, they may actually be putting in the equivalent of 18 percent of pay because there is a much shorter timeframe to fund his benefit as compared to their maybe putting in only 1 or 2 percent of pay for the 25-year-old because they expect that individual to be with the employer for a 40-year period.

So, they have very different effects on those two types of plans, and I think those are changes that would adversely affect defined benefit figures.

Going back to your——

Senator NICKLES. How detrimental would the rollback of the entry age from 25 to 21 be to defined benefit plans?

Mr. SALISBURY. In terms of number of plans terminated or created, I am not sure that it is easy to come up with a number. I think that the real question is, would it provide additional retirement income. The simulations that we and the Government have done, moving the participation age in a defined benefit plan back to 21 would basically provide no additional retirement income at some additional cost.

From an employer's perspective, if his objective is the provision of retirement income, that may well serve to make a defined contribution plan more attractive because he will feel it is more efficient in terms of the use of his dollars.

Senator NICKLES. What about the sex-neutral actuarial tables?

Mr. SALISBURY. A great number of pension plans have used sex-neutral tables for 10, 15, or 20 years. It simply tends to be a planning decision on the part of the plan sponsor which can be accommodated.

I think the real question there is whether that is the kind of change that you decide to make today for the future or you decide to make that kind of change today and apply it to the past. If you apply it to the past, you have very, very large costs to incur that have to be spread. In a pension program that could result in lower benefits for some of the people now in the plan.

Senator NICKLES. Mr. Salisbury, we thank you very much for your appearance, and also for the indepth study you have given us and the charts which accompanied it. I appreciate that very much.

Mr. SALISBURY. Senator, thank you. One final point. You have under your folder a single sheet of paper that has an advertisement on it from Dean Witter, Reynolds.

On the opposite side, we did some brief calculations to indicate, if you will, the defined benefit/defined contribution juxtaposition. As you will see from the ad, it indicates that what they are advertising is a $192,000 eventual income for a $20,000 contribution. What they are willing to guarantee—$39,278—is significantly less than that, which is basically their view of what they would be able to earn—nominal return of 3.43 percent.

If you look at the bottom half of the table, you will find that, assuming 5 percent inflation, the present value of their guarantee—$14,485—is significantly less than the dollar value—$20,000—of the contribution being made.

Such investment results can be generalized to individual retirement accounts and to all defined contribution programs as compared to defined benefit programs. I think it indicates very clearly the kind of risks that exist for the employee and retirement income provision with one type of plan versus the other.

Thank you.

Senator NICKLES. Thank you.

The next panelist that we have is Dr. Richard Spies from Princeton University. I had the displeasure of seeing Princeton beat Oklahoma State University over the weekend.

Dr. SPIES. I am glad you noticed that.

Senator NICKLES. I did notice that.

Dr. SPIES. I hope you did not watch yesterday.

Senator NICKLES. You will be very brief, I am sure. [Laughter.] Please go ahead.

STATEMENT OF RICHARD R. SPIES, ECONOMICS DEPARTMENT, PRINCETON UNIVERSITY, PRINCETON, N.J.

Dr. SPIES. Thank you. My name is Richard Spies. I am a member of the economics department of Princeton University, and I have been asked to come and talk to you this morning about the current health and future prospects of defined benefit plans.

Before I address myself to those issues, I should first make it clear that I am by no means an expert in this field, if there is such an animal. My normal research interests are in the economics of higher education and, to a lesser extent, in corporate finance, and I have taught courses in finance and microeconomics.

My interest in pension issues and whatever expertise I can claim stem from the fact that I was asked first by Governor Byrne and more recently by Governor Kean to serve on a series of task forces and commissions charged with reviewing the investment of public employee pension funds in New Jersey.

These assignments have been educational for me and have given me some sense of the major issues facing your committee, but my work is concentrated mainly on the issue of social investing of pension funds. As a result, I cannot claim to be anything like an expert on pension issues generally, and I suspect I will learn more from our discussion this morning than you will.

Having made all the appropriate disclaimers, let me turn now to the subject at hand, the current health and future prospects of defined benefit pension plans. Before I comment directly on those issues, however, let me first make two general observations about the way in which discussions of pension funds are normally structured.

While these observations do not speak directly to either the current health or future prospects of pension plans, I think they do have a significant effect on the way people think about those issues. And, as I am sure no one here would dispute, the way you ask the question always affects the answer you receive. For that reason, I think these observations are more than just an intellectually interesting digression from the main subject.

My first observation is that the differences between a defined benefit plan and a defined contribution plan are frequently overstated. I realize that the mechanics of these two plans are very different for employers, and even more so for regulators because of the specific requirements of ERISA. But I am not at all sure that the differences are very great for the average beneficiary.

I believe this observation is particularly appropriate in collective-bargaining situations where both wages and retirement benefits are set by a process of negotiation between representatives of employees and employers. In that context, both labor and management view, or at least ought to view, wages and retirement benefits as two different forms of compensation competing for the same scarce resources.

At a time when high and uncertain rates of inflation make regular cost of living adjustments necessary to maintain the real level of retirement benefits, it is clearly possible for employees to share in the risks associated with a particular benefit package if the value of that benefit is allowed to erode over time.

When this happens, a defined benefit plan begins to look much more like a defined contribution plan, in which the employee routinely bears most of that risk. I have not seen any good empirical analysis of who actually bears what share of the risk under these different plans, but I would expect such an analysis to show that the only difference is the degree to which this risk is shared by employers and employees, rather than the more clear-cut qualitative distinction normally assumed.

For that reason, I tend myself to think of these issues in terms of the status of pension funds as a whole and I do not get too excited about shifts from one type of plan to another.

My second general observation has to do with the question of funding; in particular, the calculation about whether an individual pension plan is fully funded or not. This is an extremely important question that bears on both the current health and future prospects of that plan, and I certainly would not want to imply that the calculations are not valuable.

At the same time, it is important to realize that the apparent precision of these calculations—specifically, the ratio of assets to fund liabilities—is about as believable as your favorite economist's prediction of the inflation rate in 1985, or, worse yet, in the year 2025.

As any good actuary will tell you, these calculations require a large number of assumptions about economic and demographic trends up to 50 years into the future, and the chances of any actuary making accurate projections of all those trends are about as good as the chance that my 6-year-old son could tackle John Riggins in the open field.

At the risk of belaboring this point, let me try to illustrate the effect of relatively small changes in one of the most important of these variables—the rate of return on the investments of the pension fund.

Suppose, for example, we were setting up a new pension fund for young employees and had promised these people a life annuity equal to 2.5 percent of average salary for every year of work completed, assuming that all employees retire at age 65.

Assume further that we agree to set aside an amount equal to 10 percent of each employee's salary to fund this benefit. We then ask our friendly actuary to tell us whether the plan is fully funded, taking into account both current and likely future obligations.

The actuary makes some very simplistic assumptions about mortality rates and other demographic factors, and if he assumes a real rate of return on investments of 3 percent per year—that is, real adjusted for inflation—he ought to report that the plan is only 50 percent funded.

If I did not like that answer, though, and managed to persuade him that a 4-percent real rate of return was possible, then I would be able to report with a straight face that our plan was 70 percent funded, and a 5-percent rate of return would make it fully funded.

Since most economists and investment managers would consider themselves very successful if they could predict future rates of return within 1 or 2 percentage points, I find it hard to place much confidence in a single point estimate of unfunded liabilities that can be so dramatically affected by a difference of a single percentage point in this total rate of return assumption.

Thus, while I believe that the general problem of underfunding is a very real one, I do not place much stock in particular calculations of the degree of that underfunding. You have to make some assumptions about these variables to get any sense at all about the magnitude of the problem, let alone the viability of possible solutions, but I urge you to examine carefully the assumptions used by different analysts in reaching their particular conclusions.

This is an area where, because of the magic of compounding, an analyst can, with the best of intentions, choose his assumptions in such a way as to document a problem that does not really exist or to assume away a problem that does exist.

As I understand it, the major issue before us today is whether the current tax treatment of employer contributions to pension funds should be revised, and if it were revised, how that might affect retirement provisions in this country. There are also questions about what effects such revisions might have on the general allocation of capital funds in the economy, but I think I will pass on that one for now.

It seems to me that there are three possible approaches to reducing the current level of tax expenditure for employer-supported pension plans: First, taxing the employer's contribution at the time it is made rather than waiting until it is actually paid out to the retiree; second, taxing the investment earnings of the pension funds as they are realized instead of, or in addition to, considering them taxable income for the retiree at the time they are paid out; and, third, reducing the importance of employer-funded plans altogether and relying instead on individual employees to make their own retirement provision through IRAs or some other new vehicle, thus reducing the overall level of funds eligible for such tax benefits.

In the first two cases—taxing employer contributions and taxing investment returns—the major disadvantage for pension plan beneficiaries and contributors is the loss of what amounts to an interest-free loan from the U.S. Treasury.

In effect, by deferring any taxes on these funds until the time they are paid out as retirement benefits, the current tax law permits the pension plans to invest these funds for as much as 50 years without having to pay anything for that privilege.

Clearly, this feature of the tax code provides a substantial benefit to pension funds and their beneficiaries. For example, for a person in a 30-percent tax bracket with 40 years to go before retirement, taxing contributions at the time they are made could reduce his after-tax retirement benefit by 15 percent or more, in effect making the Treasury that much better off.

The second alternative, taxing investment returns, would have an even greater effect on a person's final retirement benefit mainly because our current tax laws do not distinguish between inflation-adjusted rates of return and those returns necessary simply to compensate the investor for the lower value of the dollar. In fact, in terms of interest, we tax people for pure inflation adjustments.

In effect, by taxing nominal returns rather than real returns, it may well be that such a policy would result in an actual decline in the real value of the funds that have been contributed over time.

For example, taxing investment returns at a 30-percent rate, the marginal tax rate of my imaginary participant, might reduce the final retirement benefit by as much as 70 percent. As an aside, that same disincentive is built into the tax laws for interest earned on other forms of saving, which makes the natural impulse to spend more and save less during periods of high inflation even more understandable.

The third possibility for reducing the cost of these tax deferrals is to reduce or eliminate the tax advantages for employer-supported pension plans and encourage greater use of individual retirement mechanisms such as the IRA. For this approach to be successful in reducing tax expenditures, of course, it must either reduce the overall level of contributions for which such tax deferrals are permitted, or cause a shift in the income distribution of the participants away from the higher tax brackets.

Since the latter result is extremely unlikely, it really comes down to a matter of reducing overall retirement saving. Clearly, the impact of such a policy would be to reduce actual retirement benefits, or else require future subsidies from other presumably public sources.

If, for example, reliance on individual retirement mechanisms led people to postpone saving for retirement until age 45 rather than starting them almost immediately on an employer-funded plan, the final retirement benefits could be reduced by as much as two-thirds.

Clearly, all these numbers are illustrative only, and the precise effect of any possible change in the tax laws would depend on a host of economic and demographic factors which require a more complicated kind of analysis than I have attempted here today.

At the same time, the possibility of reducing future retirement benefits by as much as 70 percent is sufficiently frightening to me that it makes me wonder about the wisdom of seeking to reduce the current level of tax expenditures for private pension plans.

In spite of my skepticism about the accuracy of the assumptions used in calculating the adequacy of current pension funding to meet future retirement obligations, I am still convinced that the average plan is significantly underfunded, especially if one considers the need for future cost-of-living adjustments.

In addition, the aging of the postwar baby boom suggests that the fraction of the population collecting such benefits will be even higher 30 and 40 years from now than it is today. If the private pension funds which are being developed right now prove to be woefully inadequate to meet the needs of these future retirees, the pressure on public funds—social security, in particular—will be enormous.

Rather than running the risk of having to face that political pressure and the economic cost of responding to it, I would be inclined to do everything I could today to encourage greater reliance on private pension plans. Even so staggering a sum as $56 billion may be a small price to pay in current tax expenditures to provide that encouragement and support.

I thank you for your attention and I hope these comments prove helpful.

[The prepared statement and additional material of Mr. Spies follows:]

Testimony of Richard R. Spies
Department of Economics
Princeton University
Subcommittee on Labor
Committee on Labor and Human Resources
United States Senate
March 21, 1983

Good morning. My name is Richard Spies; I am a member of the Economics Department at Princeton University; and I have been asked by Mr. Carroll (Counsel to the Committee) to come talk to you this morning about "the current health and future prospects of defined benefit plans, both single and multi-employer." Before I address myself to those issues -- which are broad enough to permit me to talk about almost anything -- I should first make it clear that I am by no means an expert in this field. My normal research interests, for example, are in the economics of higher education and, to a lesser extent, in corporate finance, and I have taught courses in finance and microeconomics. My interest in pension issues -- and whatever expertise I can claim -- stem from the fact that I was asked, first by Governor Byrne and more recently by Governor Kean, to serve on a series of task forces and commissions charged with reviewing the investment of public employee pension funds in New Jersey. These assignments have been very educational for me and have given me some sense of the major issues facing your committee and others concerned about pension arrangements, but this work has concentrated mainly on the issue of "social investing" of pension funds. As a result, I suspect that I will learn more from our discussion this morning about more general pension issues than you will. (I realize that the social investing issue is not of primary concern to this group, but I have submitted copies of the report of our first New Jersey task force and a more recent paper I prepared for a joint labor-management conference on pension issues, partly to present my views on that subject in case it does become an issue for you at some later point, and partly just to show that I do know something about at least some aspect of this general subject.)

Having made all the appropriate disclaimers, then, let me turn now to the subject at hand: the current health and future prospects of defined benefit pension plans. Before I comment directly on those issues, however, let me first make two general observations about the way in which discussions of pension plans are normally structured. While these observations do not speak directly to either the current health or future prospects of pension plans, I think they do have a significant effect on the way people think about those issues. And, as I am sure no one here would dispute, the way you ask the question almost always affects the answer you receive. For that reason, I think these observations are more than just an intellectually interesting digression from the main subject.

My first observation is that the differences between a defined benefit plan and a defined contribution plan are somewhat overstated. I realize that the mechanics of these two types of plans are very different for employers -- and even more so for pension regulators because of the specific requirements of ERISA -- but I am not at all sure that the differences are very great for the average beneficiary. I believe this observation is particularly appropriate in collective-bargaining situations -- which account for about half the total assets of private pension funds and a significantly larger fraction of public employee funds -- where both wages and retirement benefits are set by a process of negotiation between representatives of employees and employers. In that context both labor and management view -- or ought to view -- wages and retirement benefits as two different forms of compensation competing for the same scarce resources. At a time when high -- and uncertain -- rates of inflation make regular cost of living adjustments necessary to maintain the real (i.e. inflation-adjusted) level of retirement benefits, it is clearly possible for employees to share in the risks associated with a particular benefit package by permitting the value of that benefit to erode over time. In this sense, a defined benefit plan begins to look much more like a defined contribution plan in which the employee bears most of that risk. I have not seen any good empirical analysis of who actually bears what share of the risk under these different plans, but I would expect such an analysis to show that the only difference is the degree to which this risk is shared by employers and employees, rather than the more clear-cut qualitative distinction normally assumed. For that reason, I tend -- myself -- to think of these issues in terms of the status of pension funds as a whole, and I don't get too excited about shifts from one type of plan to another.

My second general observation has to do with the question of funding: in particular, the calculation about whether an individual pension plan is "fully funded" or not. This is an extremely important question that bears directly on both the current health and future prospects of that plan, and I certainly would not want to imply that the calculations required by ERISA and other regulations are not valuable. At the same time, it is important to realise that the apparent precision of these calculations -- specifically, the ratio of assets to "fund liabilities" --- is about as believable as your favorite economist's prediction of the inflation ratio in 1985 -- or, worse yet, in the year 2025. As any actuary will tell you, these calculations require a large number of key assumptions about economic and demographic trends up to 50 years into the future, and the chances of any actuary making accurate projections of all those trends are about as good as the chance that my 6-year-old son could tackle John Riggins all by himself in the open field.

At the risk of belaboring this point, let me try to illustrate the effect of relatively small changes in one of the most important of these variables: the rate of return on the investments of the pension fund. Suppose, for example, we were setting up a new pension fund for young employees and had promised those people a life annuity equal to 2.5% of average salary for every year of work completed, assuming that all employees retire at age 65. Assume further that we agree to set aside an amount equal to 10% of each employee's salary to fund this benefit. We then ask our friendly actuary to tell us whether the plan is fully funded, taking account of both current and likely future obligations. If the actuary makes some very simplistic assumptions about mortality rates and other demographic factors and if he assumes a real (i.e. inflation-adjusted) rate of return on investments of 3% per year, he ought to report that the plan is only "50% funded." If I didn't like that answer, though, and managed to persuade him that a 4% real rate of return was achievable, then I would be able to report with a straight face that our plan was "70% funded." (A 5% rate of return would make it essentially "fully funded.") Since most economists and investment managers would consider themselves very successful if they could predict future rates of return within one or two percentage points, I find it hard to place much confidence in an estimate of unfunded liabilities that can be so dramatically affected by a difference of a single point in this total return assumption. Thus, while I believe that the general problem of underfunding is a very real one, I do not place much stock in particular calculations of the degree of that underfunding. I realize that you have to make some assumptions about these variables to get any sense at all about the magnitude of the problem -- and the viability of possible solutions -- but I urge you to examine carefully the assumptions used by different analysts in reaching their particular conclusions. This is an area where, because of the magic of compounding, an analyst can, with the best of intentions, choose his assumptions in such a way as to document a "problem" that doesn't really exist --- or disprove a problem that does exist.

As I understand it, the issue before us today is whether the current tax treatment of employer contributions to pension funds should be revised, and if it were revised how that might affect retirement provisions in this country. There are also questions about what affect such revisions might have on the general allocation of capital funds in the economy, but that question is even harder to answer. Given the sheer size of these pension funds -- more than $800 billion as of the second quarter of 1982 -- it is clear that changing the tax treatment of contributions and/or investment earnings would have an important impact on capital markets generally, but it is impossible to predict what the overall effect of such a change would be without knowing what the additional tax revenues would be used for; e.g. reducing Federal borrowing requirements, financing an income tax cut, paying for higher expenditures on Social Security, and so on. Because I have no way of knowing how those factors would work themselves out over time, I will confine my remarks this morning to the more narrow topic of the pension funds themselves.

It seems to me that there are three possible approaches to reducing the current level of tax expenditure for employer-supported pension plans: (1) taxing the employer's contribution at the time it is made (by calling it taxable compensation presumably) rather than waiting until it is actually paid out; (2) taxing the investment earnings of the pension funds as they are realized, instead of (or in addition to) considering them taxable income for the retiree at the time they are paid out; and (3) reducing the importance of employer-funded plans altogether and relying instead on individual employees to make their own retirement provisions through IRA's or some new vehicle, thus reducing the overall level of funds eligible for such tax benefits.

In the first two cases -- taxing employer contributions and taxing investment returns -- the major disadvantage for pension plan beneficiaries and contributors is the loss of what amounts to an interest-free loan from the U.S. Treasury. In effect, by deferring any taxes on these funds until the time they are paid out as retirement benefits, the current tax law permits the pension plans to invest these funds for up to 50 years without having to pay anything for that privilege. Clearly, this feature of the tax code provides a substantial benefit to pension funds: the precise value of this benefit depends on the individual employee's marginal tax rate and the number of years until his or her retirement, but it is clearly significant. For example, for a person in a 30% tax bracket with 40 years to go before retirement, taxing contributions at the time they are made could reduce his after-tax retirement benefit by 15% or more. Moreover, the second alternative, taxing investment returns, would have an even greater effect on a person's final retirement benefit, mainly because our current tax laws do not distinguish between inflation-adjusted rates of return and those returns necessary simply to compensate the investor for the lower value of the dollar. In effect, by taxing nominal returns rather than real returns, it may well be that such a policy would result in an actual decline in the real value of these funds over time. (As an aside, the same disincentive is built into the tax laws for interest earned on other forms of saving, which makes the natural impulse to spend more and save less during periods of high inflation more understandable.) For pension plans, taxing investment returns at a 30% rate -- the marginal tax rate of my imaginary participant -- might reduce the final retirement benefit by as much as 70%.

The third possibility for reducing the cost of these tax deferrals is to reduce or eliminate the tax advantages for employer-supported pension plans and encourage greater use of individual retirement mechanisms such as IRA's. For this approach to be successful in reducing tax expenditures, of course, it must either reduce the overall level of contributions for which tax deferrals are permitted or cause a shift in the income distribution of the participants away from the high tax brackets. And, since the latter result is extremely unlikely, it really comes down to a matter of reducing overall retirement savings. Clearly, the impact of such a policy would be to reduce actual retirement benefits -- or else require future subsidies from other, presumably public sources. If, for example, reliance on individual retirement mechanisms led people to postpone saving for retirement until age 45 rather than starting them almost immediately in an employer-funded plan, final retirement benefits could be reduced by as much as two-thirds.

Clearly, all these numbers are illustrative only, and the precise effect of any possible change in the tax laws would depend on a host of economic and demographic factors which require a much more complicated kind of analysis than I have attempted here today. At the same time, the possibility of reducing future retirement benefits by as much as 70% is sufficiently frightening that it makes me wonder about the wisdom of seeking to reduce the current level of tax expenditures for private pension plans. In spite of my skepticism about the accuracy of the assumptions used in calculating the adequacy of current pension funding to meet future retirement obligations, I am still convinced that the average plan is significantly underfunded, especially if one considers the need for future cost of living adjustments. In addition, the aging of the post-war baby boom suggests that the fraction of the population collecting such benefits will be even higher 30 years from now than it is today. If the private pension funds which are being developed right now prove to be woefully inadequate to meet the needs of these future retirees, the pressure on public funds -- Social Security in particular -- will be enormous. Rather than running the risk of having to face that political pressure -- and the economic cost of responding to it -- I would be inclined to do everything I could today to encourage greater reliance on private pension plans. Even so staggering a sum as $56 billion may be a small price to pay in current tax expenditures to provide that encouragement and support.

I thank you for your attention and I hope these comments prove helpful to you in your deliberations.

Report of Task Force on
The Use of State Pension Funds
to Further Economic Growth in New Jersey

Introduction and Acknowledgements

Our Committee was appointed on November 20, 1981, and our charge was to "investigate whether there are new ways in which the State [of New Jersey] could invest public employee pension funds in a matter contributing to the economic growth of the State as a whole." In the letter of appointment, Governor Byrne asked us to submit a report on our findings before the completion of his term in office and this report is intended to fulfill that charge.

Since our appointment, we have met a total of four times -- December 4, December 18, and December 31, 1981 and January 13, 1982. We have also attempted to review as much of the available literature on this subject as time has permitted, including importantly the reports of similar groups in other states and the writings of several articulate critics and advocates of broader investment policies for state pension funds. In this latter category, we benefited especially from the work of Lawrence Litvak, the author of Pension Funds and Economic Renewal[1/], who elaborated on his written views in a personal presentation to the committee.

With the exception of Litvak, our committee elected not to invite presentations by individuals or organizations outside our immediate membership.[2/] The primary reason for this decision was the lack of time available for such

[1/] Lawrence Litvak, Pension Funds and Economic Renewal, Council of State Planning Agencies, Washington, D. C., 1981.

[2/] The only other exceptions were the representatives of the Governor's Office, particularly Mr. John J. Huston, the Deputy Director of the Office of Policy and Planning; and Mr. Roland Machold, the Director of the Division of Investment. We benefited enormously from the participation of these individuals in our discussions, and their special perspectives were invaluable throughout our deliberations. All opinions expressed in this report are, of course, solely the responsibility of the Committee members, but we hope Mr. Huston and Mr. Machold have helped us avoid obvious errors of fact or logic.

meetings[3/], and our subsequent conclusion that the most we could accomplish in the time we did have was to recommend appropriate directions for further discussions by some successor group and to define some general principles that such a group might follow in those discussions. As a result, we felt that more specific discussions with a variety of expert witnesses and advocates of different views on this subject would not be appropriate at this time. On the other hand, our meeting with Mr. Litvak was an important part of our own research effort.

The members of our Committee have come to these discussions with a variety of different perspectives and experiences. Each of us has had some experience (either theoretical or practical) in the general area of investment policy, but none of us claims to be an expert in the field of investing for social objectives. We have all come to these discussions convinced that any steps that might be taken to enhance economic development in the State or improve the welfare of its citizens should be considered very carefully by the Governor's Office and the Investment Council. At the same time, we are completely persuaded that no such actions should be permitted if they involve any compromise in the pension funds' primary objectives: achieving the maximum return possible, at an appropriate level of risk, for the intended beneficiaries of these investments, the past and present members of the various public employee organizations; and minimizing the cost to the State's taxpayers of providing those pension benefits. As a Committee we approached our task with enthusiasm, but also with a considerable degree of skepticism about the possibility of actually achieving such secondary goals without compromising that primary objective -- in terms of either the return earned by the investments of the pension funds or their risk level.

Finally, we should note that our Committee was not asked to review the current structure of the Investment Council and the Division of Investment,

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[3/] Our Committee had less than two months to conduct its investigation and prepare this report. In other states such studies have taken a year or more: California, for example, first appointed such a task force on June 30, 1980 and that group's final report was completed only last fall.

and we have not attempted to do so. Similarly, we have not tried to form any view of the appropriateness of the Council's current investment policies unrelated to the basic question of increased investment in New Jersey. We did not, for example, consider the appropriateness of the mix of different investment instruments within the pension funds' overall portfolio. Nor did we consider the issue of proxy votes for the common stocks held by the pension funds; clearly, many proxy resolutions raise issues of "social responsibility" for public investors, but those issues do not normally extend to the question of economic development in a single state. In general, however, we have the impression that the current structure and policies have served the State and the pension fund beneficiaries very well over the years, and we would be reluctant to see any major changes in that structure without very careful consideration.

General Principles

In the course of our discussions, several general principles have emerged as sensible guidelines for the pursuit of broader social objectives through pension fund investments. While these principles seem self-evident to many of us, we have been surprised to learn that they have been ignored in much of the literature on this subject. As a result, we believe it would be useful to articulate these general guidelines explicitly before moving on to a discussion of specific investment alternatives. In our view, those guiding principles include:

(1) Investments which involve rates of return that must be subsidized by the pension funds are not appropriate at any time. Such investments necessarily result in reduced pension benefits for State employees or the need to increase State contributions to the pension funds to maintain those benefits even in the face of these lower returns. In our view, subsidized investments are never appropriate for public employees pension funds, no matter how worthy the social objectives those investments are meant to accomplish. If those social objectives are so worthy that such subsidies are in order, then a direct State (or Federal or municipal) appropriation should be considered. The appropriation process is

designed precisely for the purpose of deciding where public funds can achieve the greatest good for the citizens of the State, including (but not exclusively) those who are employees of State or municipal agencies; the pension funds have other objectives and are not the appropriate vehicles for such subsidies. Other, more indirect forms of subsidy are also inappropriate, we believe, whether those subsidies involve assuming an increased level of risk without adequate compensation or investing in instruments which result in excessive administrative or selection costs for the pension funds.

(2) Investing in instruments for which an established market already exists is normally of only marginal usefulness to the broader social objectives which those instruments are meant to serve. If the pension funds purchase government-guaranteed mortgages, for example, the net effect of that action may well be to displace other, presumably private funds that would have found those securities attractive on their own investment merits. Under these circumstances, investment in these securities by the pension funds would achieve little or nothing in terms of the desired social objectives; in our view, such purchases are, as social investments, purely symbolic.

(3) Legislative actions or regulations requiring pension funds to invest specified percentages of their assets in particular "socially responsible" forms are almost always counter-productive. For example, a formal requirement that x% of New Jersey pension funds be invested in New Jersey entities would (depending on how the term "New Jersey firms" was defined) almost certainly lead to a symbolic substitution of one group of investments for another in the pension funds' portfolio, without any effect at all on the amount of capital actually invested in New Jersey. To the extent that such legislation or regulations could be written specifically enough to require that capital would end up being invested in firms that would not otherwise be able to sell their securities, then those investments would almost certainly involve some degree of explicit or implicit subsidy by the pension funds. Moreover, even if those particular investments were appropriate at the time the requirements were imposed, it is not at all clear that the same requirements would be appropriate under differ-

ent economic and social conditions: the capital needs of different segments of the State economy have a way of changing rapidly over time, while legislative requirements and administrative regulations are normally adjusted much less frequently. In general, we believe it is much more sensible to rely on the judgment of the people on the Investment Council and within the Division of Investment to take account of the broader needs of the State whenever it is possible to do so without compromising the basic investment objectives, rather than mandating specific "socially responsible" policies ahead of time.

Specific Investment Possibilities

The analysis of specific investment opportunities is -- or should be -- basically an empirical question: are there investment opportunities in the State of New Jersey which simultaneously offer competitive risk and return characteristics and achieve broader public objectives, but are not able to attract the funds they require without special efforts by the State pension funds? If capital markets in the State are working efficiently, such opportunities should not exist and anyone looking for them is in a kind of "Catch 22" situation: any investment offering a competitive return at an appropriate level of risk should be able to attract the necessary funds without any special consideration from the State pension funds; if, on the other hand, the investment cannot attract such funds, then, almost by definition, it must be offering a return that is not competitive and any pension funds committed would involve the kind of implicit subsidy we said earlier was inappropriate.

It is possible, however, that certain inefficiencies do exist in capital markets at any given moment which might be exploited by the pension funds. In particular, it is difficult to know with certainty whether other funds are truly available for all investments that really do offer a competitive return. In cases where such funds are not available, a portfolio the size of the State pension fund may well be able to play an important leadership role in helping to develop the market for these instruments and in setting an appropriate price. Such efforts are unlikely to be dramatic in nature or in scale, but they may be able to make an important difference on the margin. Again, though, the existence of such opportunities is an empirical question, and a complete answer requires a more thorough analysis of the State's financial markets than we have been able to conduct in the amount of time available to us. Nonetheless, we do have some observations, based on our own experiences and impressions, about several of the investment vehicles which have been suggested under the general rubric of socially responsible investing:

1) Tax-exempt issues of State and municipal agencies. Even though such issues are clearly designed to serve useful social purposes, these investments are not at all appropriate for State pension funds. The fact that the interest received on such bonds is exempt from Federal (and some state) income taxes means that they can offer a lower return and still be attractive to investors in high tax brackets. Pension funds do not pay income taxes on their investment earnings, however, and so there is no offsetting compensation for these lower returns.

2) Government-guaranteed securities. In general, the existence of a government guarantee is likely to assure adequate capital funding even without special consideration from the State pension fund. Further research is necessary to determine whether market inefficiencies really do exist here, but our impression is they do not. If that is the case -- and we believe it is -- special efforts by the pension funds to invest in such instruments will, in terms of achieving those social objectives, be largely symbolic and superfluous.

3) Housing instruments. Several forms of residential mortgage instruments have been suggested, all the way from issuing individual home mortgages to buying packages of GNMA securities. In general, we are skeptical about most of these suggestions, feeling that the high cost of mortgage money (and of housing itself) is much more a problem in current markets than the availability of such money; without explicit subsidies, there is very little the pension funds can do to lower those costs. Looking at some of the specific instruments that have been suggested, we would make the following comments:

First, the investment of pension funds in mortgages for individual State employees or retirees does not seem to us to be appropriate. The Division of Investment does not have the necessary staff, the administrative structure, or the localized expertise to make such mortgage loans.

Second, purchases of government-guaranteed mortgage loans may be useful in some cases, but by and large their value in helping to achieve social objectives is only symbolic. Again, though, such investments are already being made by the pension funds.

Third, any purchases of private, non-guaranteed mortgages should be reviewed carefully to insure that no implicit or explicit subsidies are involved, to the detriment of the pension funds' primary beneficiaries. It is important that the pension funds not be put in the position of the "lender of last resort," picking up mortgage packages no other investor would consider purchasing.[4/] At the same time, we feel there is a leadership role the pension funds can play in this area, paying particular attention to New Jersey issues. The Investment Council's current policy of limiting the proportion of any such issue it will purchase to 20% probably represents a reasonable balance between these two concerns, in that it prevents the pension funds from being the lender of last resort -- indeed 80% of the issue has to be marketed to other investors -- while at the same time allowing the pension funds to play a significant leadership role in the placement of New Jersey mortgages.

Fourth, the existence of State-wide or regional mortgage pools might make the purchase of private mortgages less difficult for the State pension funds, and possibly other investors as well. Such intermediaries would allow investors to pool the risk associated with these investments and share the administrative costs of selecting specific mortgage packages. There has been some discussion about the possible formation of intermediaries of this kind, but they have not met with much success to date. Still we believe it is an idea worth pursuing.

[4/] One of our members compared this position to that of the insurance company forced to provide automobile insurance for all of the "assigned risk" pool, without being given any opportunity to sell to the more profitable segments of the market.

It is not the role of the Investment Council and the Division of Investment to create such organizations -- although they have tried to encourage them in the past and the Council's current regulations do permit investment in pools of conventional mortgages. It is possible, however, that the Governor's Office and the Legislature can work together with the New Jersey financial community to help encourage the development of such pools and to provide the support necessary to make them attractive and competitive investments.

Finally, we believe that the time is not right for pension funds to take the lead in developing shared appreciation mortgages or other forms of investment in which the lender holds an equity interest in the property. In addition to all the personal and legal problems of determining how that equity is shared between the individual resident and the lender/investor, the pension funds would almost certainly face substantial administrative costs trying to oversee such a program. Moreover, as a non-taxable organization, the pension funds would lose out on the tax deductions and deferrals available to other,taxable investors such as banks and insurance companies.

4) Direct loans to New Jersey businesses. These loans face many of the same objections as direct purchases of private mortgage packages, and again the pension fund should not be forced to be the lender of last resort for debt that could not be sold elsewhere. Moreover, well-established markets exist for most corporate debt, and Federal and State programs already reach some of the firms which are too new or too small to raise money in those markets. Again, more research would need to be conducted before anyone could reach a definitive conclusion, but it is certainly our impression that the market is generally efficient in this area and there is no special contribution the pension funds can make at this time.

5) Venture capital and other equity investments. New issues of the common stock of very small companies have been suggested by many people as an area where the efficiency achieved by more traditional markets is lacking. As a result, extraordinary returns are said to be available for investors willing to take some risk and invest in what has become known as "venture capital."

It is the nature of financial markets, however, that investment vehicles which consistently offer above-average returns invariably get discovered and quickly become very popular. As a result of that popularity, the extraordinary returns those investments had been offering dwindle to a more reasonable level (where "reasonable" takes into account the level of risk being assumed relative to other investments available in the market). Again, more research would be useful, but it is our general impression that there are sufficient venture capital funds available in New Jersey at the present time to meet the needs of promising new ventures. In general, we believe that other government actions.-- tax policies, regulatory policies, community infrastructure, educational and training programs, etc. -- along with general economic and business conditions, play a much larger role in the encouragement of new business in the State than anything in the capital markets themselves (other than the basic cost of capital). As a result, we do not expect that there is a major role for the pension funds to play in this area.

Next Steps

It is clear from the preceeding discussion that we are generally impressed by the steps that have already been taken by the Investment Council and the Division of Investment to do what they can to encourage economic development and other broader social objectives in the State. It is also clear that we are generally skeptical about whether significant new investment opportunities really do exist to encourage further development, without compromising the primary objectives of the pension funds. As a general rule, we believe that the normal capital markets are usually the best vehicle for meeting the various capital needs in the State, without any special underwriting from State pension funds.

Throughout our discussion, however, we have been frustrated by the apparent lack of useful data and thoughtful analysis in this entire area. As was indicated at several points in this report, the question of whether or not there are specific investment opportunities unmet by existing capital markets which offer competitive returns to potential investors and achieve broader social objectives is basically an empirical one. Yet, as far as we can tell, very little rigorous analytical work has been done to determine whether those opportunities really do exist. In the time we had available, then, we were forced to rely on more anecdotal evidence and our own impressions of the capital markets in the State.

In view of this lack of hard evidence, our conclusions should be regarded as tentative. We believe that efforts should be made to solicit the views of people within the State who are closer to the various capital markets than most of us, to see whether there is any evidence at all of such market failures. In addition, a careful and systematic examination of the experiences and findings of other states should be undertaken. If the results of those studies seem to indicate the real possibility that "gaps" in capital funding do exist, appropriate data should be collected and analytical studies undertaken, along with a review of the possible institutional changes which might be required in order to pursue the kinds of approaches described here and elsewhere. Until these steps have been completed and until consistently persuasive evidence has been gathered to show that pension funds can be invested to achieve these secondary objectives without compromising the primary goal of maximizing the investment return for the beneficiaries, we believe that no formal change in investment policy should be made. The primary obligation of the pension funds to provide for the financial security of 360,000 beneficiaries requires that we do nothing less.

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What Investment Strategies Should Pension Funds Pursue to Serve the Short-Term and Long-Term Interests of Beneficiaries?

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Introduction

By the end of 1982 pension funds accounted for more than $800 billion of investable monies, an amount equal to about one-sixth of the total capital pool available in the United States today. Moreover, by their very nature pension funds constitute a much larger fraction of available long-term capital, the funds most naturally invested in the basic structural elements of our national economy. As a result, the investment decisions of pension funds have a significant impact on the allocation of capital funds across the various sectors of our national economy, in effect helping to determine where future economic growth will come.

The investment of pension fund assets also has a significant impact on the personal well-being of millions of Americans, both those currently collecting pension benefits and those still working. Together with ~~Social~~ Social Security payments, private and public pension funds now constitute the primary source of retirement income for the vast majority of Americans, having long since replaced personal savings in this role. With mortality rates dropping for most age groups, more and more people are reaching retirement age with a reasonable expectation of enjoying a period of retirement much longer than their mothers and fathers -- let alone grandmothers and grandfathers -- ever imagined possible. One large pension fund now assumes, for example, that a person who retires at age 65 can expect to collect retirement benefits for something like 17 years after retirement, even without any provision for survivors benefits. What this means, in effect, is that the proverbial "actuarial average" person will be retired for a period of time roughly equal to 40% of the time he or she spent working. If the recent trend in mortality rates continues, the baby-boom generation will be collecting such benefits for even longer periods of time when they retire 30 or so years from now. Obviously, then, the accumulation of an adequate pension benefit will become -- and already is -- a major concern for all of us.

Clearly, one major determinant of the value of an individual pension fund is the amount contributed to that fund on behalf of each person, either by the individual himself or herself or by the person's employer. Equally important, however, is the rate of return that can be earned on those funds during the period of time they are invested; that is, between the time they are contributed on the employee's behalf and the time they are actually disbursed as retirement benefits. Since contributions are usually made over a working career of something like 40 years or more, and since benefits are paid out over the entire retirement period (17 years, in at least one group's actuarial tables, plus whatever period is required for survivors benefits), some of this money can be invested for more than a half century. A very small difference in the average rate of return on these investments over this period can, because of the magic of compounding, have a very large effect on either the final retirement benefit or the contribution required during the working years.

Suppose, for example, that an employee contributes each year to a defined-contribution pension plan (or has contributed for him) an amount equal to 12% of his then-current annual salary. If salaries generally inflate at 8% per year and the total return earned on the investment of the pension fund averages 12% per year, that person can expect to receive an annual retirement benefit equal to something like one and a half times his final salary.[1/] If, on the other hand, the investment returns average only 10% per year (two percentage points better than inflation, rather than four), that retirement benefit would be only about 90% of final salary.

For defined-benefit plans, of course, it is the employer who is most affected by variances in the level of investment returns. Suppose, for example, that an employer was contractually committed to providing a pension benefit equal to 150% of the retiree's last annual salary. Under the conditions described earlier, as long as annual investment returns of 12% could be achieved, the employer could meet that commitment by contributing an amount equal to 12% of the person's current salary into the pension fund each year, assuming of course that everyone works for 40 years and meets all the other actuarial assumptions. If, however, the fund is earning investment returns of only 10% per year, that annual contribution must be raised to approximately 20% of salary each year.[2]

The purpose of these examples is not to demonstrate that one particular contribution is better than any other: clearly, the adequacy of any plan depends on many different factors -- having to do with the situations of both the employer and the employee -- much too numerous and too complicated to describe here. Rather, the purpose is to demonstrate the very substantial effect that small variations in overall investment return can have on either the value of a pension plan to the employees or the cost to employers -- or both. With total pension fund assets rapidly approaching one trillion dollars, tiny fractions of percentage points in investment returns can mean billions of dollars for beneficiaries and/or contributors. Clearly, any steps that can be taken to increase these overall rates of return should be considered very seriously, and any actions which have the effect of limiting returns should be assessed with the very real cost of these lost opportunities clearly in mind.

Finally, it should be said that the dichotomy which has been drawn between defined-benefit plans and defined-contribution plans in terms of who bears the cost of low investment returns -- or reaps the rewards of high returns -- is, in my view, substantially overstated. Technically, of course, defined-benefit plans require employers to contribute whatever amount is necessary to provide that agreed-upon benefit, in effect requiring them to make up for low investment returns through greater corporate contributions. At the same time, employers almost always think of such contributions as part of an overall compensation package, and higher costs for retirement benefits might well lead them -- particularly in a collective bargaining environment -- to reduce wage offers or other benefits. At the very least, there will be a tendency for employers to let inflation erode the value of those retirement benefits (as well as wages and other benefits) if investment returns are not sufficiently high. What this means, in effect, is that both employers and employees (not to mention retirees) have good reason to worry about the investment returns earned by their pension funds.

This paper is divided into two major sections, one dealing with traditional investment choices and the lessons that might be learned from the mistakes of the past, and the other addressing the general issue of social responsibility in the management of pension fund investments. These are both extremely complicated issues and there are no magical solutions to problems raised there. At the same time, it seems clear that the investment performances of many pension funds have been less than satisfactory in recent years, and it is certainly appropriate to look back at the apparent mistakes of the past to try to develop new strategies for the future. The purpose of this paper, then, is to point out some of the problems faced by fund administrators as they try to develop appropriate investment strategies for the future, and to suggest some general principles they might follow.

Traditional Investment Choices: Strategies For the Future

It has long been accepted that one way to earn higher than average returns from one's investments is to assume a greater than average amount of risk. Both intuition and empirical research suggest that investors who are willing to assume additional risks in assembling their portfolios of investment assets can expect to be compensated for that risk in the form of a somewhat higher average rate of return. Since most investors are generally risk averse,[3] this added compensation is necessary to induce people to hold these securities. Such risk premiums are the reason, for example, that an A-rated bond has to offer a slightly higher interest rate than a similarly structured AA or AAA-rated bond, and why total returns on common stocks are generally higher than those on corporate bonds issued by the same company.[4]

The dilemma facing investment managers today is that these traditional relationships seem to have broken down (at least for the present time), and the tradeoffs between risk and return that are described in the textbooks no longer seem to apply. Indeed, as Table 1 demonstrates, returns on common stocks (as measured by total investment returns earned by the Standard & Poor's composite average) have actually lagged behind those earned by both Treasury Bills and the Salomon Brothers Bond Index over the last decade. (Note also that the variability of all those returns has been unusually high in recent years as well.) As with so many

Table 1

Comparative Rates of Return: Common Stocks, Corporate Bonds, Government Bonds, and Treasury Bills

	Common Stocks	Corporate Bonds	Government Bonds	Treasury Bills	CPI
1960	0.5%	9.1%	13.8%	2.7%	1.5
1961	26.9	4.8	1.0	2.1	0.7
1962	-8.7	7.9	6.9	2.7	1.2
1963	22.8	2.2	1.2	3.1	1.6
1964	16.5	4.8	3.5	3.5	1.2
1965	12.5	-0.5	0.7	3.9	1.9
1966	-10.1	0.2	3.6	4.8	3.4
1967	24.0	-5.0	-9.2	4.2	3.0
1968	11.1	2.6	-0.3	5.2	4.7
1969	-8.5	-8.1	-5.1	6.6	6.1
1970	4.0	18.4	12.1	6.5	5.
1971	14.3	11.0	13.2	4.4	3.
1972	19.0	7.3	5.7	3.8	3.
1973	-14.7	1.1	-1.1	6.9	8.
1974	-26.5	-3.1	4.4	8.0	12.
1975	37.2	14.6	9.2	5.8	7.
1976	23.8	18.6	16.8	5.1	4.
1977	-7.2	1.7	-0.7	5.1	6.
1978	6.6	-0.1	-1.2	7.2	9.
Average annual rate					
1960-69	7.8%	1.7%	1.4%	3.9%	2.
1970-78	4.5%	7.5%	5.3%	5.9%	6.

Source: Roger G. Ibbotson and Rex A. Sinquefield, Stocks, Bonds, Bills, and Inflation: Historical Returns (1926-1978). Charlottesville, Virginia, 1979. Data shown are annual returns earned by the S&P Composite Index, the Salomon Brothers Corporate Bond Index, a long-term government bond portfolio constructed by Ibbotson and Sinquefield, and a series of one-month Treasury Bills respectively.

other segments of the economy, financial markets have had to adjust to inflation rates considerably higher than any experienced in recent memory. Even more importantly for financial markets, inflation rates have fluctuated widely over the last decade, with the result that market participants have found it very difficult to predict accurately future inflation rates. Interest rates have fluctuated widely as well, both as a reaction to changing expectations about inflation rates and in response to fiscal and monetary policies practiced at the national level. As a result of all this uncertainty, market risk [5] became a much more important factor for both common stocks and fixed income securities during this period, and the traditional risk-return tradeoffs had to be redefined to a certain extent. One serious problem facing today's portfolio managers is knowing how to decide whether the historical relationships among these competing investments will reassert themselves in the years ahead or whether we will continue to see both risk and return characteristics of the kind we have experienced in the 1970s. Most economists believe that markets will adjust to this uncertainty about inflation rates and the traditional risk-return relationships will reassert themselves, but most of us have been saying that for almost ten years now.

Given the current volatility of financial markets and the degree of uncertainty that exists about future trends in these markets, it is very difficult to suggest specific investment strategies for pension funds -- or any other type of investor -- with any degree of confidence. At the same time, there are some general rules that all fund administrators should consider when developing such strategies for the investment of pension fund assets, such as: maintaining a truly diversified portfolio; adopting a long-term perspective in choosing investments -- and in evaluating investment performance; and developing explicit investment objectives and strategies, and then sticking by them. While there is obviously a great deal of room within these general guidelines for fund administrators to exercise discretion in the selection of individual investment assets, adherence to these principles could help to provide a more coherent framework for such choices.

Diversification. Diversification has long been accepted by investors as sensible means of reducing the risk associated with a given portfolio. Investment managers have appealed to such diversification, however, primarily in considering which common stocks to include in a given portfolio. Indeed, the distinction between firm-specific risk (which empirical evidence suggests can be eliminated by choosing a diversified portfolio containing as few as 15-20 carefully chosen common stocks) and systematic or market risk (which is much more difficult to diversify away because of the tendency of most stocks to move in the same direction as a result of changes in general market conditions) is now so much a part of market lore that stock portfolios are routinely evaluated on the basis of the degree of market risk they have assumed.[6] While pension fund managers have generally recognized the need for such diversification in their common stock portfolios (even before economists developed fancy names for it), it is not at all clear that they have achieved anything like full diversification in their overall portfolios. Pension funds are certainly not unique among investors in this respect, but one lesson of the past decade for all investors is that diversification across markets is as important as diversification within particular markets.

In order to be truly diversified, an investment pool should contain more than AAA-rated corporate bonds and blue chip common stocks. Other investments that might be considered include mortgage pools or other non-corporate fixed income securities, commercial real estate properties, foreign securities, the so-called "second-tier" common stocks, venture capital investments, and some form of participation in the rapidly growing options and commodities markets. It is certainly not the case that every pension fund ought to hold some preordained mix of all these different types of investments, but it is clear that most pension funds have been exceedingly restrictive in their past investment practices. It appears that a legitimate concern about the riskiness of individual securities has led pension funds to pass up opportunities to achieve higher overall returns -- with the individual risks associated with specific assets at least partially neutralized through diversification. In the field of venture capital, for example, it takes only one Haloid or Apple Computer in a portfolio to offset several such investments in companies that never get past the basement workshop stage. It may even be, as the Batterymarch group has suggested, that some of the best investments are in companies either approaching or actually going through bankruptcy proceedings where, although the risk of default is obviously high, the greatly discounted prices of these assets create opportunities for substantial gains. In a truly diversified portfolio with a healthy mix of supposedly "safer" securities, a modest investment in such a "bankruptcy pool" might be a very sensible strategy -- and well within the bounds of normal prudency.

I do not mean to suggest by this analysis that every pension fund should buy up securities of bankrupt corporations, or that they should invest heavily in venture capital funds. Rather, my point is that pension funds should be alert to new and non-traditional investments, evaluating the risks associated with individual securities in the context of a strategy for the overall portfolio. When such risk is accepted as part of an overall investment strategy within the context of a diversified investment pool, the chances for higher overall rates of return can be substantially enhanced. It is clear from recent interpretations of the "prudent man" rule through ERISA and IRS guidelines that such investment strategies are becoming "acceptable" for pension funds; I personally believe pension funds should take greater advantage of such opportunities in the future.

Long Term Perspective. It is ironic that many pension funds, which should by their very nature take a long-term view of investment returns, have fallen into the trap of chasing short-run market trends in too many instances. This is not the place to analyze past practices of pension funds, but there is at least anecdotal evidence that several pension funds have fallen victim to this tendency over the last decade or so, at least partially explaining their relatively poor investment performanc over this period. Because market shifts frequently occur rapidly and with very little warning -- witness the bond and stock market rallies of late last summer -- it is essential for managers to develop a long-term approach to investment strategies. The probability that an investment manager can consistently predict short-term rallies and declines in various markets is exceedingly low, and a strategy of seeking to take advantage of such fluctuations may well lead to lower overall returns in the long run. If nothing else, the effort to shift a portfolio frequently to take advantage of short-term market fluctuations will lead to significant churning of the portfolio, which normally ends up benefiting no one but the securities brokers who earn substantial commissions.

In addition to adopting long-term investment strategies, fund administrators should take a long-term perspective in evaluating the performance of investment managers. A formal policy of investing for the long term is not likely to have much impact on actual investment strategy if the investment management organization (whether internal or external) is evaluated on the basis of quarterly or annual investment results. An organization that feels in danger of losing an investment account if it fails to match or exceed a certain level of performance over a relatively short period of time has a very strong incentive to try to anticipate short-term market fluctuations, no matter what the fund's formal policy statements say about long-term perspectives. In effect, focusing on short-run returns to evaluate investment performance almost always has the effect of creating a kind of "horse race" mentality among portfolio managers, normally to the detriment of the funds themselves. Obviously, fund administrators need to be able to evaluate investment performance on a regular basis -- and to make changes in the management arrangements when that performance fails to meet the agreed-upon objectives -- but, in my judgment, such evaluations should be based upon investment results achieved over a period of at least four or five years.

Explicit Strategies and Objectives. Ideally, investment managers should be free to exercise discretion with respect to the implementation of a given investment strategy, with the understanding that they will be evaluated -- over an appropriate period of time -- on the basis of the results they achieve compared to the results achieved by others following similar strategies; but the responsibility for developing that overall strategy should lie with the fund administrators, not with the investment managers. For such a division of responsibility to work effectively, however, those strategies must be spelled out as explicitly as possible so that the managers know what is expected of them. Among the parameters that might be specified in such an investment policy statement are the following:

(1) The investment objectives of the fund, and the standard against which investment performance is to be judged. It is possible, for instance, to set a minimum rate of return which the fund is expected to achieve over a given period of time. As an alternative, investment performance could be compared to some

market average (e.g. the Standard & Poor's average or the Salomon Brothers Bond Index) or to the performance of a specified group of comparable funds. The important thing is that the objective be clearly stated -- for example, exceed the S&P average, or rank in the top quarter of all pension funds in excess of $1 billion -- so that both the investment manager and the evaluator know what is expected. (Another non-trivial advantage of having such explicit objectives is that it gives the beneficiaries of the fund an opportunity to evaluate both the investment managers and the fund administrators.)

(2) The amount of time over which investment performance is to be evaluated. It is argued elsewhere in this paper that this period should be at least 4-5 years, but, no matter what the period is, it is essential that both managers and evaluators know that ahead of time.

(3) The amount of risk that can be assumed. This parameter can be stated as an overall constraint -- by specifying an acceptable value of the Beta coefficient, for example -- or as a series of limitations on various types of investments. My own preference is for the former approach, but the latter involves fewer practical problems and is by far the more common approach (where such constraints are specified at all).

(4) General guidelines for the mix of assets in the portfolio. Such policy statements frequently specify a range of acceptable values for the ratio of stocks to fixed income securities, for example. Many also specify similar ranges for investments such as real estate holdings, options, foreign investments, and so on. I have previously argued that it is important to maintain some degree of flexibility to pursue appropriate opportunities in non-traditional markets, so these guidelines should not be too specific. At the same time, choosing the general mix

of investments is an important part of developing an overall investment strategy, and it should be treated as a matter of policy not just of implementation.

Social Investing: Can We Achieve Secondary Objectives Without Compromising Overall Investment Returns?

Under several different names and in several different forms, social investing has been an issue for pension fund administrators for decades, probably since the beginning of separate pension funds. Should pension funds invest in companies doing business in South Africa? What about other countries with poor human rights records' Or companies that engage in flagrant anti-labor activities? Or which discriminate against women or minorities in employment or other business practices? Should pension funds make a special effort to invest in companies or organizations which earn especially high marks in these areas or which make other contributions to fund beneficiaries or to society as a whole? These and other similar questions have been debated -- usually without any real resolution -- for years.

In recent years a new twist (or at least a new emphasis) has been added to these discussions with the appearance of studies such as Barber and Rifkin's The North Will Rise Again[7/] and Lawrence Litvak's Pension Funds and Economic Renewal.[8/] These studies, and others like them, have argued that pension funds should give special consideration to investments designed to further "desirable" social goals such as economic development (usually in a specific geographic region) or additional housing. In most cases it is argued that such investments can help improve the lives of plan beneficiaries in ways other than by guaranteeing retirement income, without having any material effect on overall investment returns and the ability of the fund to provide the guaranteed retirement benefits. In effect, they argue that such investments can do double duty by achieving two objectives at the same time.

These issues arise mainly because pension fund beneficiaries have a direct stake in such investments as housing and economic development -- and because $800 billion is too large a pool of money to go unnoticed by advocates of such investments. (This last point ignores the funds' obligations to beneficiaries; some estimates place such liabilities at a level more than $100 billion above even this enormous amount.) Why not, it is argued, achieve desirable social objectives through the investment of these funds if that can be done without compromising the primary objective of providing retirement benefits for the plan beneficiaries? A task force studying the investment of public employee pension funds in California wrote in the introduction to their interim report:[9]

> "Pension fund assets have grown to the point that their investments have a major impact on the economy. With this expansion of economic power, more demands will be placed upon the use of pension fund assets. Greate employee/beneficiary participation alone can insure that the funds are both protected and responsive to broader economic objectives.
>
> "While the task force does not advocate restricting the investment of state and local retirement funds to California, it does believe that there should be some level of responsiveness by these funds to the tax base of their origin, consistent with geographic diversification requirements of a well-balanced portfolio.
>
> "The task force recognizes that public pension funds, which depend for their health on a strong economy, have a self-interest in promoting jobs and economic development in California. Many private pension plans have a similar interest when contributions to the funds are derived primarily from the local economy.
>
> "The task force acknowledges that the primary source of contributions and the ultimate guarantor of the public retirement systems are the citizens and the taxpayers of the state.
>
> "By facilitating the development of new ways to increase the flow of pension capital into productive investment in California -- thereby creatin more employment opportunities -- the task force believes that the State can receive a compensating return in revenues and a decrease in budget

> expenditures for such costs as welfare and unemployment.
>
> "Bolstering the tax base in this way will support the ability of the State and the localities to adequately fund the retirement systems.
>
> "Sound economic and social policies require maintenance and strenthenin of the domestic industrial base. Beset by maturing technologies, unproductive conglomerate mergers, the flow of capital abroad and a diminished savings rate at home, the American economic base is deteriorating. This has been the heart of the recent debates over 'reindustrialization' or 'revitalizing the economy.'
>
> "Productivity increases, and hence non-inflationary improvements in the standard of living, can best be assisted at the state level by stimulating productive investments in California's industrial base -- both modernizin existing industries and helping to stimulate the development of new industries.
>
> "Since billions of dollars in public employee and private pension funds -- the accumulated savings of millions of workers -- are the greatest capita resource we have in the state, the task force believes these funds should be encouraged to more consciously and systematically engage in this revitalizing process to the benefit of all Californians.
>
> "The legitimate role of government in this process is to work together with financial institutions to create new investment options that meet the prudent requirements of pension investing while responding to public policy goals."

Clearly, the California task force saw the potential benefits to the State of California of such investments. They argued that, since public employees are all citizens of the State, they would benefit in the same way as other taxpayers from these investments. Moreover, since public employees ultimately depend on state or local tax revenues for their jobs, these employees have a special interest in such projects. As long as these investments can be made without substantial risk or loss of return -- "consistent with geographic diversification requirements," in the words of the task force -- isn't this an ideal way to get these pension funds to serve two worthy purposes at the same time?

The problem, of course, is that it is not always obvious that such investments ca be made without giving up something on the investment side, either in terms of a lower (i.e. below-market) rate of return or in terms of greater risk. No one (that I know of anyway) would argue that the kinds of investments advocated by the California task force are inappropriate when the pure investment returns they offer are truly competitive with other investments with similar risk characteristics. The differences of opinion arise when those investment returns are not truly competitive, or, more frequently, when the degree to which they are competitive is difficult to guage.

A task force similar to the one in California was formed in New Jersey in the fall of 1981. In its final report, this group emphasized the situations in which it believed such "targeted" investments would be inappropriate. In one way or another, all those situations involved investments for which the returns were -- or at least appeared to be -- uncompetitive.

The task force then attempted to spell out a set of general guidelines to be used in evaluating proposals for social investments in order to avoid such compromises[10]

> "In the course of our discussions, several general principles have emerged as sensible guidelines for the pursuit of broader social objectives through pension fund investments. While these principles seem self-evident to many of us, we have been surprised to learn that they have been ignored in much of the literature on this subject. As a result, we believe it would be useful to articulate these general guidelines explicitly before moving on to a discussion of specific investment alternatives. In our view, those guiding principles include:
>
> "(1) Investments which involve rates of return that must be subsidized by the pension funds are not appropriate at any time. Such investments necessarily result in reduced pension benefits for State employees or the need to increase State contributions to the pension funds to maintain these benefits even in the face of these lower returns. In our view, subsidized investments are never appropriate for public employee pension funds, no matter how worthy the social objectives those investments are meant to accomplish. If those social objectives are so worthy that such subsidies are in order, then a direct State (or Federal or municipal) appropriation should be considered. The appropriation process is designed precisely for the purpose of deciding where public funds can achieve the greatest good for the citizens of the State, including (but not exclusively) those who are employees of State or municipal agencies; the pension funds have other objectives and are not the appropriate vehicles for such subsidies. Other, more indirect

> forms of subsidy are also inappropriate, we believe, whether those subsidies involve assuming an increased level of risk without adequate compensation or investing in instruments which result in excessive administrative or selection costs for the pension funds.
>
> "(2) Investing in instruments for which an established market already exists is normally of only marginal usefulness to the broader social objectives which those instruments are meant to serve. If the pension funds purchase government-guaranteed mortgages, for example, the net effect of that action may well be to displace other, presumably private funds that would have found those securities attractive on their own investment merits. Under these circumstances, investment in these securities by the pension funds would achieve little or nothing in terms of the desired social objectives; in our view, such investments are, as social investments, purely symbolic.
>
> "(3) Legislative actions or regulations requiring pension funds to inve specified percentages of their assets in particular "socially responsible" forms are almost always counter-productive. For example, a formal requirement that x% of New Jersey pension funds be invested in New Jer entities would (depending on how the term "New Jersey firms" was define almost certainly lead to a symbolic substitution of one group of investments for another in the pension funds' portfolio, without any effect at al on the amount of capital actually invested in New Jersey. To the extent that such legislation or regulations could be written specifically enough to require that capital would end up being invested in firms that would no otherwise be able to sell their securities, then those investments would almost certainly involve some degree of explicit or implicit subsidy by the pension funds. Moreover, even if those particular investments were appropriate at the time the requirements were imposed, it is not at all clear that the same requirements would be appropriate under different economic and social conditions: the capital needs of different segments of the State economy have a way of changing rapidly over time, while legislative requirements and administrative regulations are normally adjusted much less frequently. In general, we believe it is much more sensible to rely on the judgment of the people on the Investment Council and within the Division of Investment to take account of the broader needs of the State whenever it is possible to do so without compromising the basic investment objectives, rather than mandating specific "socially responsible" policies ahead of time."

The issue, then, seems to come down to the question of whether a particular social investment requires any compromise in the fund's investment objectives, and whether to invest in it if it does require such a compromise. The California task force described this dilemma well in their interim report when they first stated that:[11/]

> "The task force asserts that prudence is the basis of all investment decisions. It is paramount that pension funds be managed prudently and in the best interests of beneficiaries so that retirement income is secure. The financial integrity of a retirement system must be the cardinal concern of any pension investment policy.
>
> "The task force advocates market rate investments. Any other policy would discriminate against beneficiaries."

but then went on to argue:

> "Programs of less-than-market-rate investments that may directly benefit the pension plan members should be a matter jointly determined by the trustees, fund managers and the beneficiaries themselves so as to prudently balance costs and benefits."

Who is to determine the extent of the benefits of any specific investment for the pension plan beneficiaries (some of whom have already retired and may have little or no stake in the economic vitality of the region but a very large stake in the level of pension benefits)? Who will measure the costs of any such investment in terms of compromise in the financial return? Then, finally, who will decide -- and how -- whether the benefits really do exceed the costs?

There are, of course, some situations in which the costs and benefits of potential social investments are relatively clear, and it is frequently possible in these cases to make a sensible decision which most fund participants can accept quite readily. It does not seem appropriate, for example, for a pension fund -- particularly one developed in a collective bargaining context -- to invest in the securities of corporations which consistently advocate and practice blatantly anti-labor and anti-union positions (e.g., J. P. Stevens). I have already argued, on the other hand, that it does make sense to invest some portion of a fund's portfolio in venture capital pools and other similar investments in small business. In the first case, the benefit of social investment (actually divestment in this example) in terms of demonstrating support for the principles of collective bargaining is both clear and significant, and the cost of such an action is almost certainly very small. (In the J. P. Stevens case, it would have been a relatively simple and inexpensive matter to exchange all J. P. Stevens securities for other securities with similar investment characteristics. Indeed, given the extensive opposition to J. P. Stevens because of its anti-union stance, it could easily have been argued that such an exchange was appropriate for purely investment reasons.) In the case of venture capital pools, the purely financial advantages of such investments within a portfolio that is truly diversified are accompanied by the additional advantage of their furthering economic development in a particular area. Here, the benefits are clearly large (at least in potential) and the costs, if you believe in the value of what I have called "true" diversification, are essentially zero. So much for the easy cases!

Investments in companies which do business in South Africa represent a much more complicated situation than the J. P. Stevens case, in my judgment. First of all, the benefits of avoiding such investments are much less clear. Unlike the J. P. Stevens situation, the companies have not themselves (in most cases) been accused of discriminatory practices. Rather the argument is that by carrying on business in South Africa they legitimatize and support the government of South Africa and its apartheid policies. Moreover, there are very dramatic differences of opinion about whether a policy of withdrawal from South Africa would end up helping or hurting the victims of apartheid.

Secondly, the cost to a pension fund of prohibiting investments in companies which do business in South Africa would be very substantial. Nearly a half of the market value of the common stocks in the Standard & Poor's composite index represents stock in companies which conduct some level of business in South Africa. Excluding such companies from what would otherwise be a reasonably diversified stock portfolio would, according to some estimates, reduce the portfolio's overall rate of return between one and two percentage points each year.

Another complicated situation arises when a company or municipality encounter severe financial problems and needs to sell additional securities in order to avoid mass layoffs and/or bankruptcy. Obviously, any securities issued by an organization in this plight involve a substantial degree of risk for the investor. Under these circumstances, how much investment risk should pension funds ssume in order to protect the jobs of their constituents? How large a risk premium should they demand in the interest rate? Does it make any difference if the fund's existing liabilities are fully covered by fund assets? And who should decide how much risk is appropriate?

The near-bankruptcy of New York City in the mid 1970s provides a good exampl of such a situation. As one component of the solution to that crisis, municipal employee unions were "persuaded" to invest employee pension funds in City-supported notes and bonds, 12/ on the argument that employees had a clear stake in the fiscal survival of New York City and the investment of pension funds was necessary to preserve union jobs. Those particular investments did not have any substantial adverse impact on pension fund assets, but that is more an indication of good luck and the skill of the various individuals involved in making the best of a bad situation than it is a proof that such investments are appropriate means of preservin union jobs.

There are, I believe, several general problems -- illustrated by these examples -- which the proponents of social investments have either failed to address or have not yet resolved fully. Those problems include the following:

(1) Identifying potential investments that both accomplish worthy social objectives and earn reasonably competitive returns. By and large, most supporters of such investments advocate rules for determining such investments which are

either extremely simplistic (e.g., invest in companies that have major operations in a particular geographic region) or purely subjective -- or both. Finding investments that achieve the desired social objectives without compromising the basic investment objectives presents the fund administrator with what the New Jersey task force described as a "Catch 22" dilemma:13/

> "any investment offering a competitive return at an appropriate level of risk should be able to attract the necessary funds without any special consideration from the State pension funds; if, on the other hand, the investment cannot attract such funds, then, almost by definition, it must be offering a return that is not competitive and any pension funds committed would involve the kind of implicit subsidy we said earlier was inappropriate

(2) Maintaining beneficiary support for particular social investments. Given that most pension funds have thousands of participants with varying views on -- and stakes in -- such secondary objectives, the difficulty of achieving any kind of consensus for a particular form of social investment is potentially enormous. The problem is, of course, even more complicated in a defined-benefit plan where the employer has a clear stake in the investment of these funds as well; in these situations, it is not at all obvious how much weight should be attached to the different views of the beneficiaries and the employers.

(3) Avoiding cases of conflict of interest. Inevitably, social investments are proposed because particular people have a special interest in seeing certain projects proceed. Undoubtedly, most of these projects are proposed with the interests of all plan beneficiaries in mind, but many proposals will come forward in which the self-interest of the proposer is the primary motivation. Distinguishing between these two groups of proposals will not always be easy.

(4) Evaluating investment managers when compromises in investment returns are permitted in order to achieve secondary objectives. Because it is very difficult -- sometimes impossible -- to measure the impact of such compromises

on overall investment returns, it is hard to hold a fund's investment managers accountable for their performance when such compromises are permitted.

In general, I would argue that these problems (combined, in my case, with the belief that any compromise in the primary investment objectives of pension funds is inappropriate) make any substantial degree of social investment unrealistic and unlikely. If a particular fund elected to explore such possibilities, however, I would make the following suggestions:

(1) Keep the funds available for social investments in a separate pool, segregated from the primary investment pool where the only objectives being pursued are the purely financial ones. Such a separation limits the degree of compromise that is permitted (by limiting the amount of money on which any compromise is permitted), and allows fund administrators and beneficiaries to evaluate investment performance on the rest of the fund's assets without the complication of measuring the impact of such social investments on overall returns. The recent Chrysler-UAW agreement to invest 10% of new contributions in particular social investments is a good example of such an approach.

(2) Require joint participation with other investors in any project of this type, possibly placing a limit on the fraction of any security which the fund can purchase. Such a limit can help the fund avoid becoming a "lender of last resort" for any particular project, and requires such securities to undergo a more extensive market test.

(3) Support joint data collection and analysis efforts. The Investor Responsibility Research Center is a good example of an organization that can serve pension funds well by helping to define social investment issues and point toward specific investment decisions. In addition to providing a level of analysis that would be very

difficult for most individual funds to sustain, such organizations have the advantage of being somewhat more distant from specific investment proposals and, in most cases, more objective about their relative merits and demerits. If social investing is to be pursued more extensively in the future, it would be useful if other organizations similar to the IRRC were formed to analyse issues related to economic development in different geographic areas.

In the end, the basic issue in social investment debates comes down to one word: compromise. Everyone agrees that, if all other "things" are truly equal, then the investment of pension funds in projects that also achieve secondary social objectives is clearly appropriate. But it is seldom the case -- if ever -- that all other things are really equal, and so the arguments begin.

Footnotes

1/ This example assumes a 40-year working career and a 17-year retirement. It also assumes that all benefits are paid in the form of a level annuity with no survivors benefits. Finally, no provision is made for any reserves or administrative costs.

2/ This example overstates somewhat the effect of investment returns on required contribution rates, mainly because it assumes an almost 60-year involvement for each employee. A commonly cited rule of thumb is that a one percentage point change in investment returns will result in a 20% swing in employer costs

3/ Not every investor is risk averse, of course, and there are good reasons why at least some investors would demonstrate what economists call "risk loving" behavior. It may be, for example, that the risk associated with a particular asset is symmetric, in the sense that the probability of an unexpected investment loss is exactly offset by the probability of an unexpected gain of roughly the same size. Market risk in particular tends to behave in this way, since interest rates are, theoretically at least, just as likely to be lower than expected as they are to be higher than expected (although the experience of the last ten years or so may make us all question that assertion). This means that the chances of earning a higher-than-expected return increases as we move away from the less risky end of the investment structure, and the more optimistic among us may regard this potential gain as more than adequate compensation for the increased chances of earning a lower return. The empirical evidence suggests, however, that an overwhelming majority of investors are -- or because of institutional requirements, peer pressure, or other factors known only to themselves, behave as if they are -- risk avers

4/ It is important to emphasize, however, that it is expected returns that are the basis for investment decisions, and investment managers are no less vulnerab to unexpected occurrences than any of the rest of us. Indeed, if nothing else, the last decade should have taught all of us that investing in common stocks does not guarantee high investment returns. Despite this experience, however very few investors even today expect either long-term bonds or money-market instruments to outperform common stocks over the long term.

5/ Market risk, sometimes called systematic risk by economists, is the result of general changes in market conditions, usually reflected in changes in the general level of interest rates. Empirical evidence suggests that other, more firm-specific risk can be eliminated through a sensible diversification policy, so that market risk is the only form of risk for which the investor should be compensated in an efficient market.

6/ The most common measure of such market risk is the so-called "Beta coefficient." The Beta coeficient of a stock or portfolio is a statistical measure of the degree of correlation between the rate of return earned by that stock or portfolio and the rate of return earned by the market as a whole. Developed b econometricians and finance theorists as a part of the so-called "capital asset pricing model," Beta is now accepted as a practical tool by many portfolio managers.

7/ Randy Barber and Jeremy Rifkin, The North Will Rise Again: Pensions, Politics, and Power in the 1980's, Boston, 1978.

8/ Lawrence Litvak, Pension Funds and Economic Renewal, Council of State Planning Agencies, Washington DC, 1981.

9/ "Interim Report, Governor's Public Investment Task Force," State of California, March 1981, pp. 2-3.

10/ "Report of Task Force on the Use of State Pension Funds to Further Economic Growth in New Jersey," January 1982, pp. 3-5. I had the privilege of chairing this task force and was the principal author of the final report.

11/ Interim Report, Governor's Public Investment Task Force, pp. 1-2.

12/ Under the circumstances the unions did an extraordinary job of negotiating an arrangement whereby the actual investment returns on these securities involved much less compromise than might have been the case. The guarantees provided by the State of New York through the Municipal Assistance Corporation, combined with the joint participation in these investments with several large banks and other investors, meant that the exposure of the pension funds to possible loss was relatively small.

13/ Report of the Task Force on the Use of State Pension Funds to Further Economic Growth in New Jersey, p. 5.

Senator **Nickles**. Thank you, Doctor. A couple of questions. When you were comparing the three ways to reduce tax expenditures, you kind of then went through and found the faults of all of them.

I was surprised at your calculation under the first method which would eliminate the deductability of the contribution when made.

Dr. **Spies**. Right.

Senator **Nickles**. Your example only showed a 15-percent after-tax reduction, as compared to a having to pay taxes on the interest when earned with a reduction of 70 percent. I was surprised when I read that and found that much disparity.

I would have thought, actually, that the loss of the deductability on the income would have been the greater of the two factors.

Dr. **Spies**. No. It works the other way mainly because of the feature of the tax law which taxes interest at its nominal rate and considers all of the nominal interest earned as taxable income rather than just the real rate of return.

Essentially, what happens when you tax the contribution is you are just speeding up the collection of that amount, but then allowing what is contributed to compound at the higher pretax rate. The difference, because of compounding, favors strongly the permission to let it compound at the pretax rate.

Senator **Nickles**. Do you have any doubt or question on where they came up with this $56 billion of tax expenditure? Does that seem appropriate or inappropriate?

Dr. **Spies**. I would think that was much closer to right than the $20 or $25 billion that was estimated last year. I think if you total wage and salary income, the total personal income in this country is somewhere around $2 trillion. If you assume that between 8 and 15 percent of it is put aside for retirement provisions, that is up toward $150 billion, and given marginal tax rates, $56 billion does not seem too far off.

I would be hard put to say that it is exactly $56 billion and not $48 or $62 billion, but it is a believable number.

Senator **Nickles**. You mentioned that one possibility of reducing the tax expenditure would be to reduce or eliminate the tax advantages for employer-supported pension plans. That was done somewhat under TEFRA.

Then you went further and said to accomplish that, you are talking about moving the income distribution away from possibly some of the higher incomes into the lower incomes, as IRAs are now set. But then you went on to say it is extremely unlikely, but we have actually been doing that.

Dr. **Spies**. I think if you look at the data, is it not the case that IRAs are used heavily by higher income people? We may be moving to include more lower-income people, but I think it is still the case that the overall fraction that the high-income account for is higher than their fraction of the population.

Senator **Nickles**. Well, to expand that further, right now where the IRA limitations are you would probably have some higher incomes that would use it.

If you had a limitation, as we have now, imposed under TEFRA that higher incomes could only contribute so much in combination, whether it was defined contribution or defined benefit, equal to so many dollars—if that was lowered, it could generate more revenue If you had, conversely, an expansion as we have seen under IRAs which would benefit a greater volume, you could still accomplish that third step which you said was highly unlikely.

It struck me that have we not seen that happening to some extent?

Dr. Spies. Well, I think we have moved in that direction. I think the individual retirement account appeals probably more to the middle income rather than to the very high income.

But I think the real question is, in the absence of employer-funded plans, whether low-income people would put aside, even with appropriate tax benefits, sufficient income, income that is even remotely comparable to what is being put aside by employers today, or what should be put aside in defined benefit plans.

I think the answer is no. By and large, the evidence I have seen suggests that the money that has been put into IRA's, even the $2,000 money market funds at your local savings and loan, has largely come from money that would have been saved anyway; that the actual new savings that have been generated are fairly minimal.

To think someone making $10,000 or $12,000 or $15,000 a year would put aside even $1,000 or $500, I think, requires some documentation that I have not seen.

Senator Nickles. Let me move on to one other item. You have done some homework in the area of social investing, and I think that is included in the paper you are submitting for the record.

Dr. Spies. Right.

Senator Nickles. Could you comment on that and how it might affect the rate of return and the overall health of the private pension system?

Dr. Spies. The argument I have tried to make concerning social investment is that in any circumstance I can imagine, an investment which is made for social purposes, whether it is "social" broadly defined or more narrowly defined—a union might define social purpose as protecting the jobs of the members of that union—but, really, for any purposes other than simply to provide the maximum possible retirement benefits for employees, that kind of investment necessarily involves some compromise in the total rate of return, either in terms of the actual percentage rate of return that you can earn or in terms of the risks that you have to assume to earn that total return.

If you are having to make some compromise, you are ending up in the long run reducing the funds available to pay to retirees, and then you are creating all the problems I have talked about this morning.

Senator Nickles. OK.

Dr. Spies. I conclude that you have to make that kind of a compromise because, by and large, what people are talking about is investing in projects that no one else wants to invest in. And if no one else wants to invest in it, in a kind of catch-22 situation, I take that as evidence that it is not at least apparently offering a competitive return.

So, if you invest in it despite the fact that no one else does, then you are necessarily taking either a risk or making a compromise on the return that the market says is not justified.

Senator NICKLES. You do not think it would be to the benefit of the beneficiaries or participants in the plans?

Dr. SPIES. That is right. I think that in the long run, under either a defined contribution or a defined benefit plan, that has an impact on the retirement benefits that can be paid.

Senator NICKLES. Thank you very much for your statement today.

Our next guest is Dr. Laurence Kotlikoff from Yale University. Doctor, did I pronounce that close to correctly?

Dr. KOTLIKOFF. You did fine.

Senator NICKLES. Thank you.

STATEMENT OF LAURENCE J. KOTLIKOFF, ASSOCIATE PROFESSOR OF ECONOMICS, YALE UNIVERSITY, NEW HAVEN, CONN., AND RESEARCH ASSOCIATE, NATIONAL BUREAU OF ECONOMIC RESEARCH

Dr. KOTLIKOFF. Senator Nickles, I am honored to have this opportunity to discuss with you the current and future status of the U.S. private pension system.

I am an associate professor of economics at Yale University and a research associate of the National Bureau of Economic Research. I have been a student of both private and public pension systems for many years. Together with Mr. Daniel Smith of the National Bureau, I recently completed work on an extensive compendium of pension statistics to be published this fall by the University of Chicago.

The book is entitled "Pensions in the American Economy." An addendum to my testimony provides a summary of many of the principal findings of this research. Let me briefly describe the status of the private pension system, pointing out strengths and potential weaknesses as I see them.

Today, the U.S. private pension system plays a central role in old-age income support. Currently, one in every two workers in the private sector is covered by a private pension. One in every four private workers is either partially or fully vested. More than one-fifth of elderly households currently receive income from private pensions, representing, on average, almost one-third of their income.

Since 1950, private pension coverage has more than doubled. While the coverage rate is likely to grow through the remainder of this decade, I expect a much slower rate of growth in coverage in the future than we experienced in the past.

Regardless of the exact future growth of private pensions, it is clear that this institution is here to stay and will properly be the subject of Government oversight in the years to come.

One area of longstanding concern is the financial status of private pensions. Pension funds are playing an increasingly important role in financial markets both because of the size of their holdings and the allocation of these funds across various financial assets.

While information on the financial status of small pension plans is limited, most major U.S. corporations are now including estimates using, roughly similar actuarial methods of unfunded vested accrued liabilities in their annual reports.

If one considers vested accrued liabilities as a relevant measure of pension indebtedness, then the majority of pension plans of major U.S. corporations appear to be adequately funded, if not overfunded, according to their official reports.

While one can argue about the appropriate definition of pension liabilities, in my judgment the U.S. private pension system, in general, is financially sound. There are, of course, particular plans whose unfunded vested accrued liabilities are troubling.

My chief concern with the functioning of the U.S. private pension system is not its financial solvency. Rather, I am troubled by the extraordinary complexity of private pension provisions.

The complexity of private pension plans—in particular, defined benefit plans, which cover almost three-quarters of private participants—present difficult problems for both employers and workers in valuing pension compensation, and this complexity may be having unintended impacts on labor mobility and the hiring of particular demographic groups.

While the Employment Retirement Income Security Act of 1974 has substantially standardized pension provisions, considerable latitude remains in the choice of plan features. A typical worker today might face age and service restrictions on plan participation, a graduated vesting schedule, portability with a specified set of coparticipating employers, a social security integrated step rate or offset benefit formula, an optional peak years or terminal years earnings base, age and service-specific early retirement benefit reduction rates, special supplemental benefits prior to receipt of social security, partial or actuarial increases in benefits for work beyond the plan's normal retirement age, and limited cost of living adjustments.

Additional features would establish the worker's eligibility for disability benefits, as well as the level of those benefits. Each of these provisions can significantly influence the employee's expected pension compensation.

Even given complete knowledge of the plan's structural features and its financial status, the calculations required for both workers and employers to estimate the level of future pension compensation and the risks of receiving that compensation are very difficult.

The limited data available on worker familiarity with pension plan provisions provide basis for concern. In 1980, 8 percent of U.S. private wage and salary workers responded, do not know, to a census survey asking whether they were covered by a pension.

Of those workers who reported pension coverage, almost 1 in 5 did not know whether or not their pension was vested. The do not know response to the vesting question was given by 28 percent of workers age 18 to 25 and 12 percent of workers age 56 to 60.

These rates are sufficiently high to suggest much more limited worker knowledge of precise provisions of benefit formulae, retirement requirements, cost-of-living adjustments, and the like.

My belief that workers and plan sponsors do not fully appreciate the implications of complex pension provisions is increased when I consider the impact of these provisions on pension benefit accrual.

Figure 1 following page 8 in the testimony presents the ratio of annual vested accrued pension benefits to annual wage earnings for three hypothetical workers who begin work at ages 31, 41, and 51 for an employer with a quite simple defined benefit plan.

The plan provides 10-year cliff vesting, has an early retirement age of 55 and a normal retirement age of 65. The calculations are based on a set of reasonable economic assumptions.

The diagram indicates that for workers beginning employment at ages 31, 41, and 51, the ratio of pension benefit accrual at the age of vesting is 14 percent, 36 percent, and 64 percent of wages, respectively. In other words, for these three workers, working another year at ages 41, 51, and 61 provides the equivalent of 14 percent, 36 percent, and 64 percent wage increases for that particular year.

Workers who join defined benefit plans beyond age 40, and there are many such workers, potentially face very significant costs to switching jobs as they approach the age of cliff vesting.

In addition, plan sponsors, if they fully understand their pension provisions, have strong incentives to lay off such workers prior to the age of vesting.

There are other features of this accrual diagram that are disturbing. At the plan's early retirement age, 55, the accrual ratio falls by about 8 percentage points for the age 31 hire and 6 points for the age 41 hire. Thus, the worker who hires on at age 31 effectively faces an 8-percent real wage cut at age 55. In contrast, the worker who hires on at age 51 faces no implicit wage cut at this age. These two workers clearly experience quite different changes in incentives for continued work effort as they advance in age.

A final point that can be made with this diagram is the possible disincentive to hire the elderly associated with defined benefit plans. Consider a firm that hires a 31-year-old and an equally productive 51-year-old. Assume the firm pays both workers the same amount in direct wages for their first 9 years of employment.

In the 10th year of employment when cliff vesting occurs, the firm would have to reduce the older worker's wage by close to 50 percent to maintain equality in total pension plus nonpension compensation to the two workers. The likelihood of such on-the-job wage flexibility seems remote, suggesting that firms would simply refrain from hiring older workers. Similar potentially unintended labor market discrimination can occur between males and females and between blacks and whites.

I personally doubt that the typical worker or plan sponsor fully appreciates the impact of defined benefit plans on the time path of total annual compensation. The actuarial calculations underlying figure 1 are complex; they are complex for trained actuaries and economists, so it is difficult to see how workers and employers with little professional training could produce anything but extremely rough guesses of incremental pension compensation.

My understanding is that the typical pension plan is not providing workers and employers with professional estimates of annual increments to each worker's accrued vested pension benefits.

For a worker, failure to clearly understand the pattern of pension benefit accrual means, quite simply, that he cannot fully understand his retirement finances. Some workers may respond to this uncertainty by saving more than they would otherwise. Others may overestimate their pension saving and save too little on personal account.

Given the continuing uncertainty in social security's long-term finances, I am disconcerted by the considerable uncertainty that appears to characterize the second most important institution for retirement savings in the United States.

[The prepared statement of Mr. Kotlikoff follows:]

March 21, 1983

Testimony to the Senate Labor Sub-Committee on the Current Health of the Private Pension System

Laurence J. Kotlikoff

Associate Professor of Economics
Yale University

and

Research Associate
National Bureau of Economic Research

Senator Nickles and other distinguished members of the Senate Labor Sub-Committee on the Current Health of the Private Pension System:

I am honored to have this opportunity to discuss with you the current and likely future status of the U.S. private pension system. I am an associate professor of economics at Yale University and a research associate of the National Bureau of Economic Research (NBER). I have been a student of both private and public pension systems for many years. Together with Mr. Daniel Smith of the NBER, I have recently completed work on an extensive compendium of pension statistics entitled Pensions in the American Economy. This large volume of data surveys private as well as state and local pension coverage, pension vesting, portability, retirement, benefit provisions, pension replacement rates and pension finances. The book's preparation was financed by the National Bureau of Economic Research, a non-profit institution conducting research on numerous economic issues including the U.S. pension system. Numerous individuals in the government, the private sector, and academia greatly assisted our preparation of this manuscript. An addendum to my testimony provides a summary of many of the principle findings of this research. Let me now briefly describe the status of the private pension system, pointing out strengths and potential weaknesses as I see them.

Today the U.S. private pension system plays a central role in old age income support. Currently, one in every two workers in the private sector is covered by a private pension; one in every four private workers is either fully or partially vested. More than a fifth of elderly households currently receive income from private pensions, representing, on average, almost a third of their income.

Since 1950 private pension coverage has more than doubled. While the coverage rate is likely to continue to grow through the remainder of this decade, I expect a much slower rate of growth in coverage and particularly vested coverage in the future than we experienced in the past. Virtually all major corporations now have pension plans and these firms account for a significant fraction of U.S. private employment. Almost three quarters of pension participants are now enrolled in defined benefit plans that typically require long-term employment for vesting. The age-tenure distribution of the U.S. work force is unlikely to change radically in the near future; hence, it is hard to see how the fraction of vested defined benefit participants in the private work force could substantially increase in the 1980s as it did in the prior decades when there was a large stock of uncovered long term workers. Prospects for growth in the number of defined contribution plans and participants seem better, since this form of pension plan appears most attractive to small firms with shorter term employment. Defined contribution plans typically vest their participants more rapidly than defined benefit plans. Defined contribution plans will, however, have to compete with liberalized IRA and Keogh accounts, and they face much greater public awareness of these alterative savings vehicles than was formerly the case.

Regardless of the exact future growth of private pensions it is clear that this institution is here to stay and will properly be the subject of government oversight in the years to come. One area of long standing concern is the financial status of private pensions. Pension funds are playing an increasingly important role in financial markets both because of the size of their holdings and the allocation of these funds across various financial assets. In 1950 pension reserves represented 1.9 percent of total household wealth; in 1980 pension reserves exceeded 6.0 percent of household wealth. Pension investments are highly concentrated in financial securities. Currently pension funds own close to 15 percent of all corporate stock, 26 percent of corporate bonds, and 5 percent of federal, state, and local government securities. For the majority of pension plans, the portfolio decisions of pension fund managers directly affect the ultimate amount of pension income received by participating workers; in other cases such decisions may influence the financial valuation of the employer's enterprise, since the firm may be legally obligated to pay specified pension benefits independent of the performance of the pension fund.

Pensions may also be affecting the nation's rate of saving. Employer-sponsored pensions obviously represent a substitute for household retirement saving, but the rate of substitution may be greater or less than dollar for dollar. A key feature of saving in the form of pension benefit accrual is the illiquidity of the investment. Young households unable to gain direct access to these funds or to borrow against these assets in formal financial institutions, may be reducing their consumption and be raising their total saving above its alternative value. The tax-free accumulation of capital income within pension funds may provide incentives for increased total household saving to the extent these tax advantages are affecting marginal household consumption decisions and not simply altering the allocation of a given amount of household saving between pension and non-pension saving vehicles. Pensions could also be altering national saving if workers systematically over or underestimated the extent of retirement income forthcoming from their pensions. Similarly, stockholders of companies with unfunded pension benefit liabilities may systematically over or undervalue these liabilities. Such practices would affect stock market valuations, stockholders' perceptions of their true net worth, and, ultimately, stockholders' consumption patterns.

While information on the financial status of small pension plans is limited, most major U.S. corporations are now including estimates of unfunded vested accrued liabilities according to procedures suggested in 1980 by the Financial Accounting Standards Board. If one considers vested accrued liabilities as the relevant measure of pension indebtedness, then the majority of pension plans of major U.S. corporations appear to be adequately funded, if not over funded, according to their own official reports. The 1980 annual reports of 497 of the Fortune 1,000 largest U.S. corporations include estimates of total accrued and vested accrued pension liabilities. They also list the 1980 market value of pension fund assets available to meet these liabilities. Across all 497 corporations vested accrued liabilities totaled $137.10 billion while pension fund assets equaled $133.3 billion. For over half of these corporations, pension fund assets exceed vested accrued liabilities. Fifteen corporations reported assets that were twice the value of their vested accrued liabilities. Only 7 of the 497 corporations had assets representing less than 50 percent of their vested accrued liabilities, and two of these corporations have only recently established their pension plans.

While one can argue about the appropriate definition of pension liabilities, in my judgement the U.S. private pension system, in general, is financially sound. There are, of course, particular firms whose unfunded vested accrued liabilities are troubling. Chrysler's 1980 annual report, for example, suggested an unfunded vested liability per employee in that year of close to $10,000. In contrast, Western Electric reported a 1980 surplus in pension assets over vested accured liabilities in excess of $9,000 per worker.

My chief concern with the functioning of the U.S. private pension system is not its financial solvency, rather I am troubled by the extraordinary complexity of private pension provisions. The complexity of private pension plans, in particular, defined benefit plans, presents difficult problems for both employers and workers in valuing pension compensation and may be having unintended impacts on labor mobility and the hiring of particular demographic groups.

While the Employee Retirement Income Security Act of 1974 has substantially standardized pension provisions, considerable latitude remains in the choice of plan features. A typical worker today might face age and service restrictions on plan participation, a graduated vesting schedule, portability with a specified set of co-participating employers, a Social Security integrated step-rate or offset benefit formula, an optional peak years or terminal years earnings base, age and service-specific early retirement benefit reduction rates, partial actuarial increases in benefits for work beyond the plan's normal retirement age, and limited cost of living adjustments. Additional features would establish the worker's eligibility for disability benefits as well as the level of those benefits. Each of these provisions can significantly influence the employee's expected pension compensation. In addition to digesting a host of rules and regulations relating to structural features of the pension plan, an informed worker should be familiar with the pension plan's financial condition since pension plan default can wipe out pension claims of unvested workers and reduce a vested worker's expected pension compensation by the difference between projected and accrued benefits.

An informed worker should also understand the investment decisions of the pension fund's portfolio manager. In the case of defined contribution plans these decisions directly influence the worker's expected retirement benefit as well as its variance, since the pension fund manager is, quite simply, investing the worker's money. In the case of defined benefit plans, pension fund investment decisions influence the probability of plan default.

Even given complete knowledge of the plan's structural features and its financial status, the calculus required to estimate both the level of future pension compensation and the risk of receiving that compensation is difficult at best. The worker needs to formulate fairly precise expectations about the course of inflation and real interest rates; he or she needs to understand the set of probabilities that determine both life expectancy and the chances of experiencing employment termination prior to retirement age; finally, the worker needs to be able to actuarially discount future benefit streams and assess their risk with respect to variations in the inflation rate, potential changes in employment conditions, and other factors.

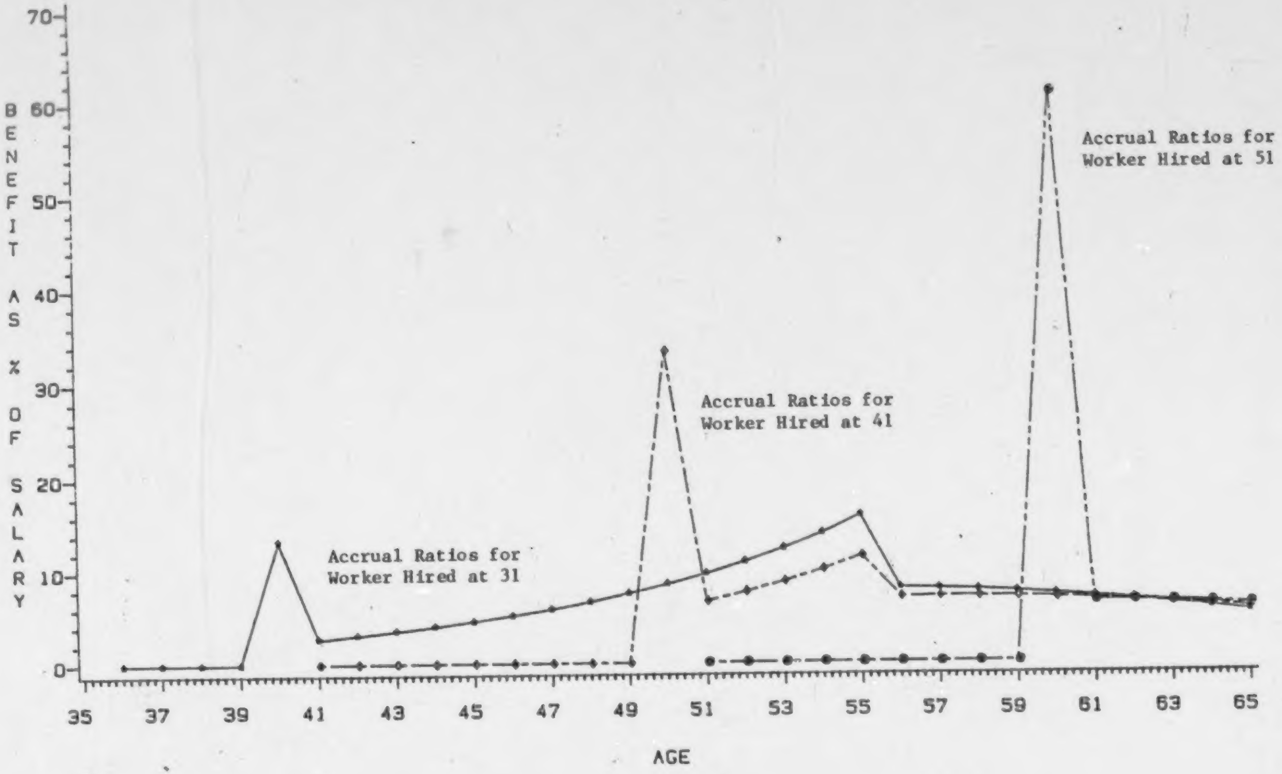
The complexity of pension provisions also poses difficult problems for employers. To "meet the market" in terms of total worker compensation, the employer must appreciate the value of non-wage as well as wage compensation being offered by his competitors and be able to assess the increment to total compensation associated with his or her own pension plan. The free market presumably alleviates some of the employer's informational problems associated with pensions. For example, employers may not need to understand precisely how 10 year as opposed to 5 year cliff vesting affects workers' perceptions of their total compensation offer. Employers can, in principle, experiment with different components of their compensation package until they attract the requisite quantity and quality of workers. But this line of argument ultimately throws the informational requirements back to the worker. Workers need to be able to assess the relative attactiveness of different pension plans in order to arbitrage differentials in total compensation across employers.

The limited data available on worker familiarity with pension plan provisions provide some basis for concern. In 1980, 8.05 percent of U.S. private wage and salary workers responded "don't know" to a census survey asking whether they were covered by a pension. Of those workers who reported pension coverage, almost one in five did not know whether or not their pension was vested. The "don't know" response to the vesting question was given by 27.85 percent of workers age 18 to 25, but only 12.43 percent of covered workers age 56 to 60. These rates are sufficiently high to suggest more limited worker knowledge of precise provisions of benefit formulae, retirement requirements, cost of living adjustments, and the like.

My belief that workers and plan sponsors do not fully appreciate the implications of complex pension provisions is increased when I consider the impact of these provisions on pension benefit accruals. Figure I presents the ratio of annual vested accrued pension benefits to annual wage earnings for three hypothetical workers who begin work at ages 31, 41, 51 for an employer with a quite simple defined benefit plan. The plan has 10 year "cliff vesting" and computes normal retirement benefits as one percent of an earnings base times years of service. The earnings base is average earnings during the last five years of employment with the plan sponsor. The plan's normal retirement age is 65, while early retirement occurs at 55. Benefits are reduced by 3 percent for each year of early retirement. The worker's nominal wage growth is based on standard merit increases plus an annual 6 percent increase due to inflation. The long term interest rate used in the calculation is 9 percent.

The diagram indicates that for workers beginning employment at ages 31, 41, and 51, the ratio of pension benefit accrual at the age of vesting is 14, 36, and 64 percent of wages respectively. In other words, for these three workers, working another year at ages 41, 51, and 61 provides the equivalent of 14, 36, and 64 percent wage increases for that single year. Workers who join defined benefit plans beyond age 40, and there are many such workers, potentially face very significant costs to switching jobs as they approach the age of cliff vesting. In addition, plan sponsors, if they fully understand their pension provisions, have strong incen-

Figure 1. PENSION INCREMENTS AS A PCT OF SALARY, BY AGE, FOR AN EMPLOYEE BEGINNING WORK AT 31, 41, 51.



NOTE: 6% WAGE INFLATION, 3% REAL INTEREST RATE.

tives to lay off such workers prior to the age of vesting.

There are other features of this accrual diagram that are disturbing. At the plan's early retirement age, 55, the accrual ratio falls by about 8 percentage points for the age 31 hire and 6 points for the age 41 hire. Thus, the worker who hires on at age 31 effectively faces an 8 percent real wage cut at age 55; in contrast, the worker who hires on at age 51 faces no implicit wage cut at this age. These two workers clearly experience quite different changes in incentives for continued work effort as they advance in age.

A final point that can be made with this diagram is the possible disincentive to hire the elderly associated with defined benefit plans. Consider a firm that hires a 31 year old and an equally productive 51 year old. Assume the firm pays both workers the same amount in direct wages for their first 9 years of employment. In the 10th year of employment when cliff vesting occurs, the firm would have to reduce the older worker's wage by close to 50 percent to maintain equality in total pension plus non-pension compensation to the two workers. The likelihood of such on the job wage flexibility seems remote, suggesting that firms would simply refrain from hiring older workers. Similar, potentially unintended, labor market discrimination can occur between males and females and between blacks and whites; workers in particular demographic groups appear to have much lower mortality probabilities than do other workers. Since pensions are paid as annuities, the pension costs of hiring, for example, a white woman relative to those of hiring a equally productive black male of the same age can differ significantly.

I personally doubt that the typical worker or plan sponsor fully appreciates the impact of defined benefit plans on the time path of total annual compensation. The actuarial calculations underlying figure I (even for this simple plan) are complex; they are complex for trained actuaries and economists, so it is difficult to see how workers and employers with little professional training could produce anything but extremely rough guages of incremental pension compensation. While I am not an expert on pension disclosure practices, my guess is that the typical pension plan is ot providing workers and employers with professional estimates of annual increments to each worker's accrued vested pension benefits. For a worker, failure to clearly understand his pattern of pension benefit accrual means, quite simply, that he can't fully understand his retirement finances. Some workers may responsd to this uncertainty by saving more than they would otherwise. Others may overestimate their pension saving and save too little on personal account. Given the continuing uncertainty in Social Security's long term finances, I am disconcerted by the considerable uncertainty that appears to characterize that second most important institution for retirement saving in the U.S.

Additional research is needed to determine the full extent of informational problems in the pension area. If there is a significant lack of information, how does this fact affect the efficient operation of the U.S. labor market, and what are the distributional implications of these informational problems with respect to wages and profits? The answer to these questions are of interest to all Americans, even those who never anticipate participating in a pension plan. As a nation, we are providing sizeable tax incentives to saving in the form of pensions. Official estimates place the 1980 revenue losses to the U.S. Treasury from pension savings incentives at $36.7 billion dollars or $229 per adult American. Is the current structure of the U.S. pension system delivering the saving and labor market results that are commensurate with this national investment? If not, what public policy approaches are needed to strengthen the U.S. pension system in meeting these objectives?

A second area of concern suggested is the potential sensitivity of real pension benefits to inflation. New data collected by the Department of Labor indicates that most beneficiaries, particularly those in large plans, can expect some type of cost of living adjustment, although not necessarily on an annual basis. On average, COLAs actually awarded fall far short of fully protecting the real value of private pension benefits. During the period 1973 to 1979, years that witnessed a 63 percent increase in the consumer price index, mean nominal pensions for beneficiaries rose by 28.82 percent. For these beneficiaries real benefits fell by 21.14 percent over the period.

Unexpected changes in the economy's long-term rate of inflation can affect a recipient's initial real pension benefit and changes in the level of real benefits during retirement years. In 1979, 14 percent of private defined benefit plans covering 27 percent of active pension participants specified benefit formulae that potentially make the real level of the first year's pension benefit quite risky to inflation occuring during the participant's working years. One example is a defined benefit plan that computes the worker's pension on the basis of a lifetime average of nominal earnings. Assuming the worker's nominal earnings just keep pace with inflation, every percentage point of inflation prior to the worker's retirement devalues (in real terms) the value of earnings received at the beginning of the worker's career and, therefore, lowers the real value of average lifetime earnings. For plans using this earnings base, a lower real value of average lifetime earnings means a smaller initial real benefit received by the worker. Assuming the plan provides no cost of living adjustments, real pension benefit payments will further decline at the rate of inflation during each year of retirement.

The real losses or gains to pension participants and beneficiaries due to inflation are associated dollar for dollar with real gains or losses to the employer. Hence, a decline in the inflation rate can quickly turn what would otherwise be a quite solvent pension fund into an acutely underfunded pension system. According to estimates reported in Pensions in the American Economy, 201 of 363 state, large city and large local plans have assets in excess of 75 percent of vested accrued pension liabilities assuming a nine percent long-term inflation rate (12 percent nominal interest rate). At a five percent inflation rate (8 percent nominal interest rate), only 171 of these 363 public plans have assets that exceed 75 percent of their vested accrued liabilities. While no comparable data have yet been developed to determine the sensitivity of private defined benefit pension finances to inflation, there is every reason to expect a similar degree of inflation sensitivity.

The apparent lack of explicit arrangements to pool these inflation risks between workers and employers does not preclude the possibility of implicit risk pooling arrangements. These can take the form of periodic revisions of pension benefit formulae that affect current as well as future workers. Additional longitudinal data is needed to determine the frequency of revisions of inflation-sensitive benefit formulae. But evidence of benefit revisions would not, by itself, lessen concern about inflation risk; one also needs to determine that such revisions are not effectively paid for in the form of lower non-pension compensation.

Another way in which workers and employers can hedge these inflation risks is to purchase assets whose real return is postively correlated with inflation in the case of workers and is negatively correlated with inflation in the case of employers. For example, pension participants with home mortgages or other nominal liabilities gain from a rise in inflation because they can repay their debts in cheaper dollars; this real capital gain on their nominal debt from inflation may partly or totally offset inflation's reduction in the real value of nominal pension benefits. Similarly, employers can hold nominal assets whose real value falls with inflation, thus offsetting the employer's gain from paying lower real pension benefits.

In short, the American pension system appears highly sensitive to inflation. Implicit insurance arrangements, may, in effect, be redistributing the gains and losses arising from changes in the rate of inflation, but as yet, there is no compelling evidence that such is the case. Alternatively, workers and employers may be self-insuring against pension-inflation risks by adjusting their private portfolios, but the extent of such behavior is not well understood.

A third general question concerning pensions and economic performance involves the impact of pensions on worker retirement. The past 30 years have witnessed a remarkable decline in the labor supply of the elderly. In 1950, 25 percent of Americans age 65 and over participated in the labor force; today's figure is roughly 12 percent. Labor force participation rates of 55 to 64 year olds have dropped from 70 percent in 1960 to 60 percent in 1979. Not only are there proportionately fewer late middle aged and elderly Americans currently working in the U.S. economy, but those who do work are working fewer hours. In 1957, 21 percent of employees over age 65 worked part-time; today's figure is 43 percent.

The Social Security system's earnings test potentially imposes a heavy implicit tax on the continued work effort of the elderly and may, in large part, explain the major post-war shift towards early retirement. Structural features of many U.S. pension plans, however, also impose major penalties for continued work effort with the current employer. Because of the difficulties of changing jobs late in life, private, state, and local pension plans may be inducing millions of elderly workers to leave the labor force. The mechanism by which the Social Security system and many pension plans induce retirement after these system's retirement ages is simply not to fully compensate the worker for foregoing current receipt of pension income.

In 1979, 22.76 percent of covered workers participated in plans that did not credit additional years of service beyond normal retirement for purposes of computing retirement benefits. Another 28.55 percent of covered workers were enrolled in plans that credited additional service after the normal retirement age only up to a specified age, on average, 70. Even for plans that credit service for some or all years after normal retirement, the increase in future pension benefits associated with continued work may not adequately compensate for the forfeit of current benefits. The degree to which additional years of credited service constitute the equivalent of an actuarial increase in accrued pension benefits depends on the particulars of the plan's benefit formulae and, in many cases, the worker's rate of nominal wage growth.

Workers who continue employment after additional years of service are no longer credited usually receive no special reward for delaying receipt of their benefits. Three quarters of covered workers participate in plans that provide neither for current benefit payments nor for increases in future benefits to workers whose additional years of service are no longer being credited. For workers in this situation, an additional year of employment with the plan sponsor means a complete loss of that year's pension benefit. This feature obviously provides a healthy inducement to discontinue employment with the plan sponsor.

Incentives for job separation can also be significant prior to the worker's attainment of the plan's normal retirement age. Once the worker passes the age at which early retirement benefits are first available, there is often a disincentive to continue employment with the plan sponsor. Many plans allow their participants to retire early with no reduction in their accrued benefits. Among plans that do apply a reduction, the reduction is often less than actuarial, causing workers who continue working for the plan sponsor to suffer a net loss measured in present value. Almost one quarter of 1979 private covered workers were in plans that specified "actuarial increases" for delaying retirement. The remaining participants were in plans that provided special increases that are apparently quite small relative to an actuarially fair increase. Based on a five percent interest rate assumption and 1971 group mortality tables, the benefit increase needed between age 62 and age 65 to insure actuarial fairness is 24.8 percent. For private pension participants with non-actuarial benefit increase formulae, the rate of benefit increase between ages 62 and 65 averages 8.2 percent. While other features of a plan's regular benefit formula can provide benefit increases for additional service, these data suggest that many pension participants face significant work disincentives even prior to the plan's normal retirement age.

Many economists argue that there are sensible and compelling reasons for firms to induce retirement through their benefit provisions. After a certain age the worker's productivity may drop below his or her current wage. In this case the worker may prefer to retire rather than continue to work at a wage commensurate with his or her diminished abilities. Inducing retirement through implicit pension benefit taxation is seen as a way to terminate the worker while preserving his or her dignity. Other economists view these retirement incentives as part of an elaborate long-term contractual relationship in which the firm enforces diligence by paying the worker less than he or she is worth when young and more than he or she is worth when old. Tilting the age-compensation schedule in this manner keeps workers on their toes by providing greater and greater incentives to continue employment. It also permits the firm to pay higher wages than would otherwise be the case. After some optimal point, however, the firm discontinues the "carrot and stick" compensation schedule and terminates the worker. Again, the loss of pension benefits due to continued employment serves as a dignity-preserving device for inducing worker separation.

While the proverbial "invisible hand" of efficient competition may well be guiding the design of these and other structural features of the American pension system, verification of this proposition is difficult. As research on these issues continues, it is important that workers, employers, and policy makers fully understand the extent of work disincentives built into many U.S. pension plans.

Addendum

Summary of Major Findings in
Laurence J. Kotlikoff and Daniel Smith,
Pensions in the American Economy,
forthcoming, University of Chicago Press

Section

I. Pension Coverage

II. Characteristics of Pension Participants

III. Characteristics of Pension Beneficiaries

IV. Structural Features of Private Pension Plans

V. Structural Features of State and Local Pension Plans

VI. Financial Status of Private, State, and Local Pension Systems

I. Pension Coverage and Pension Growth

Private, state, and local pensions now cover over 45.28 percent of the U.S. labor force. In 1950 the figure was 19.93 percent. Coverage of private wage and salary workers has more than doubled over the past three decades, from 23.79 percent to almost 50 percent. Coverage of state and local government workers has increased from 60 to 90 percent.

In 1980 over one quarter of all individuals age 60 and over reported receipt of pension income from private, state, and local pension plans; the figure in 1969 was only 13 percent. Taking elderly households as the unit of analysis, the fraction reporting pension income rose from 18.4 to 27.9 percent over this period. The fraction of the elderly receiving pensions will, almost certainly, continue to grow through the 1980s and 1990s reflecting recent increases in the fraction of U.S. workers covered by private, state, and local pensions.

Growth in pension fund contributions, benefit payments, and assets has been associated with this sizeable growth in pension coverage and in the fraction of the elderly receiving pension benefits. In 1950 contributions to private pension funds represented 1.69 percent of total private sector wage and salary compensation. By 1975 the percentage was 5.10. Over the period 1950 to 1979 contributions per covered worker measured in constant 1980 dollars rose from $731.77 to $1,494.53. Contributions per covered worker (in 1980 dollars) for state and local pension plans increased from $2,098 to $3,272 between 1960 and 1980.

During the past 30 years the annual growth rate in real pension benefit payments averaged 11 percent for private plans and 7.36 percent for state and local plans. Pension benefits now represent over 12 percent of the income of the elderly, up from 3 percent in 1950.

The size and composition of pension fund assets have changed considerably since 1950. In that year the assets of private, state, and local pension funds and the reserves of insurance companies held to meet insured benefit payments equaled $60.24 billion (1980 dollars). The figure today exceeds $650 billion. Public pension assets have grown at roughly the same rate as private pension fund assets. In 1950, 27.84 percent of total private, state, and local pension fund assets were held by state and local pension funds. In 1980 the fraction was 30.44 percent.

For non-insured private pension funds the share of assets invested in equities rose from 33.71 to 59.15 percent over the years 1955 to 1980. The equity share of state and local pension portfolios grew from 2.0 percent in 1950 to 21.3 percent in 1979. These figures likely understate the movement into equities, since investments in pooled funds have increased steadily over the last 30 years. The equity share of pooled funds appears to be sizeable.

II. Characteristics of Pension Participants

In 1979 an estimated 30.2 of 67.3 million private sector workers were covered under private pension plans. Close to 70 percent of these 30.2 million were male, 89.36 percent were white, 56.36 percent were over age 40, 40.13 percent had post-high school education, 34.12 percent earned more than $15,000 per year, 49.89 percent were white collar workers, and 44.19 percent worked in manufacturing. The composition of covered workers in the public sector is somewhat different. Of the 9.43 million 1979 public sector (state and local) covered workers, 49.24 percent were male, 87.18 percent were white, 44.09 percent were over age 40, 62.86 percent reported at least a high school education, and 30.99 percent earned more than $15,000 per year.

The composition of covered workers along many of these dimensions largely reflects differential coverage rates by demographic and economic characteristics. For example, in the private sector male pension coverage was 52.9 percent in 1979, while female coverage was only 33.3 percent. For white workers, the 1979 coverage rate was 45.2, somewhat larger than the 41.9 rate for non-whites. Workers 46 years and older are more than 1.3 times as likely to report pension coverage as their younger colleagues. Close to half of private sector workers with a post-high school education report pension coverage; only 42.77 percent of less educated workers report coverage. Private sector workers with annual earnings in excess of $15,000 are 2.19 times more likely to be covered by a pension than lower paid workers. For workers in white collar occupations the 1979 coverage rate is 46.55 percent, slightly larger than the 43.31 rate for blue collar workers.

Almost three quarters of pension participants are enrolled in defined benefit plans; the remainder are enrolled in defined contribution plans. Defined benefit plans determine pension benefits on the basis of formulae that typically take into account the worker's years of service, past earnings history, and age at retirement. In defined contribution plans benefits equal the return of principle plus income earned on explicit pension fund contributions made by, or for, each participating worker.

Private pension plan participants are highly concentrated in large plans; 78.06 percent of participants belong to plans with 1,000 or more covered workers. Almost half of all private pension participants are enrolled in union plans. This statistic is striking when compared with a less than 25 percent union representation among the total private U.S. work force. "Plan entity" is another important feature of pension plans. Private plans that cover workers of more than one employer - multi-employer plans - cover 18.61 percent of private pension participants.

While 44.87 percent of the U.S. work force reported pension coverage in 1979, only 21.43 percent indicated that they were vested. Almost one fifth of covered workers indicated a lack of knowledge of their vested status. There is also a significant difference between male and female vesting rates. Covered female workers are 20 percent less likely to be vested than their covered male co-workers. The white-nonwhite differentials in vesting rates for covered workers are slightly smaller than the male-female differentials; 48.57 percent of white participants, but only 41.02 percent of nonwhites surveyed in 1979 indicated their pension benefits were vested. The probability that a worker's benefits are vested is strongly correlated with age. Fewer than one third of covered workers below age 30, but more than 60 percent of covered workers above age 50 are vested.

III. Characteristics of Pension Beneficiaries

In 1980, 6.64 million, or 19.94 percent, of the 33.30 million Americans age 60 or over reported receipt of income from either private, state, or local pension plans. For individuals age 70 and over, the fraction reporting pension income was 27.37 percent. Almost three quarters of the 6.64 million beneficiaries received private pensions. Of these beneficiaries 18.47 percent were age 60 to 64; 31.93 percent were 65 to 69; 49.60 percent were 70 or older. Over 60 percent of private, state, and local beneficiaries were male; almost 94 percent were white. Although individuals with post-high school education comprise only 18.08 percent of these elderly cohorts, they represent 25.58 percent of private, state and local pension recipients. Over 39.69 percent of the 1980 population of elderly individuals reported only a grammar school or junior high school education. These individuals account for only 27.47 percent of 1980 pension recipients.

Pension recipients report greater than average levels of lifetime earnings, but only average levels of current annual income. Across all age groups, 7.06 percent of the 1980 elderly reported $20,000 or more in annual income. Among elderly pension recipients the fraction is only slightly higher, 7.53 percent. However, for the 70 and over age group, 5.81 percent of pension recipients reported $20,000 or more in income, almost twice the percentage for the entire 70 and older age group.

Pension recipients, as one expects, are much more likely to be out of the labor market than the typical elderly individual. The employment rate (fraction of population employed) of the post 60 population was 21.87 percent in 1980; for private, state, and local pension recipients it was only 12.33 percent. Apparently, for many of the elderly, the receipt of pension income is associated with a total cessation of employment. Thus, while pension coverage of workers and the generosity of their pension benefits is highly correlated with earnings, elderly pension beneficiaries, in general, report average levels of income.

There were 22.26 million households in 1980 headed by an individual aged 60 or older. In slightly over half of these households, the household head was single. Of the single households, over three quarters were headed by a female. In 1980, 35.49 percent of married households reported pension income; the comparable percentage was 23.82 for single male-headed households and 19.36 for single female-headed households. Although married households constitute less than half of total elderly households, they account for 63.06 percent of all 1980 households that received private, state, or local pension benefits.

IV. Structural Features of Private Pension Plans

In 1980 there were an estimated 616,642 private pension plans in the United States, an enormous growth from the 14,671 plans in existence in 1951. Approximately 65 percent of these plans were defined contribution, as opposed to defined benefit, plans. Defined contribution plans are disproportionately small plans, however, and cover less than one third of private pension participants. Defined contribution plans average 34.17 covered workers, while defined benefit plans average 209.57 participants. Actually, most pension plans are fairly small. In 1977, 86.81 percent of defined contribution plans, and 59.88 percent of defined benefit plans reported fewer than 25 participants. Over two thirds of pension participants, however, are concentrated in the 5,000 largest plans that account for less than 1.5 percent of all plans.

Union plans tend to be quite large, averaging 797 participants; although they make up only 5.25 percent of all plans, their participants constitute almost half of all private covered workers. Over 38 percent of union participants are in multi-employer plans, and over 90 percent of multi-employer plan participants are union members. Multi-employer plans average 859 participants and cover 18.61 percent of private pension participants.

Subject to minimum standards established under the Employee Retirement Security Act of 1974 (ERISA), private pension plans are free to establish rules and requirements that govern participation, vesting, benefit accrual, ages of early and normal retirement, as well as provisions for receipt of disability benefits. There are a host of provisions that meet ERISA's requirements. As a consequence, there is a wide variety of pension plans. A description of the structure of U.S. plans requires examining each of the rules and requirements in turn.

Pension Participation

The initial date of pension plan participation determines, at a minimum, the date beyond which workers are formally enrolled in the plan and included in official reports to the government. For purposes of computing benefit accrual the date of plan participation is also the latest date that the plan can use. Some plans appear to use an earlier date for benefit accrual, such as the date employment commences with the plan sponsor.

About 50 percent of pension plans specify a minimum age requirement for plan participation. Most of these plans specify a service requirement as well. For plans with age requirements, over half specify age 25 as the initial age of participation; another 20 percent specify age 21. The plans specifying age 25 account for 72.56 percent of all participants in plans with age requirements. Plans with service participation requirements represent 70.06 percent of all plans. Virtually all plans with service requirements specify 3 years or less; plans with a one year service requirement cover 87 percent of all workers in plans with a service requirement. Large plans often permit immediate participation. The 20.61 percent of pension plans with no participation requirements cover over 51.17 percent of pension participants.

Fewer than one third of private pension plans restrict pension participation of elderly workers. These plans, however, cover 42.55 percent of all private pension participants. The maximum age for plan participation in these cases averages 61.78 where this average is weighted by the number of covered workers.

Vesting and Portability

Vesting provisions are a key structural feature of pension plans. Vested pension benefits are benefits to which the worker has a legal claim. Fewer than 4 percent of private covered workers are vested immediately. Slightly more than half are covered by 10 year "cliff vesting", which provides full vesting after 10 years of service, but no vesting prior to 10 years. Another 16.32 of pension participants belong to plans with cliff vesting at 3 or 5 years or with a partial or "graded" vesting that specifies a schedule of vesting accrual. Almost 5 percent of covered workers are in plans with 10 years graded vesting. Under this formula a worker's vesting rights typically increase by 10 percent for each of the first 10 years of service.

Vesting provisions differ markedly across plan types and industries. Almost two thirds of defined benefit participants, but fewer than one quarter of defined contribution participants belong to plans with 10 year cliff vesting. Over 13 percent of defined contribution participants, but only .62 percent of defined benefit participants enjoy immediate vesting. In wholesale trade 15.15 percent of participants face 10 year graded vesting; the comparable figure in mining is only 2.86 percent.

Data from the Department of Labor's EBS1 file suggests a surprisingly large degree of pension portability. Portability means that a worker can switch jobs and continue pension participation under the original pension plan or under an equivalent pension plan that credits the worker's past service with the former employer. According to the EBS1 data, close to half of all pension participants have portable pensions. Over one fifth have portability with employers who are not co-sponsors of the pension plans.

These figures should be viewed with considerable caution. They may, in part, reflect a confusion on the part of survey respondents as to whether the portability question really dealt with portability as opposed to vesting. On the other hand the correlation of portability with plan size suggests much more than simple coding errors. According to the EBS1 data, fewer than one quarter of participants in small plans with less than 25 participants, but over two-thirds of participants in plans with 10,000 or more covered workers appear to have portable pensions. This high degree of portability reported by larger plans may, in part, reflect the ability of covered workers to carry service credits to related companies only — e.g., subsidiaries. In addition, industries such as construction in which workers often switch companies report much greater than average rates of portability.

Benefit Provisions

As mentioned, over 70 percent of pension participants are enrolled in defined benefit plans that base benefits on a specified formula. There are six commonly used defined benefit formulae. Plans with these six formulae account for 86.25 percent of defined benefit participants. Roughly two fifths of the 86.25 percent of these defined benefit participants are enrolled in plans that relate benefits to past levels of earnings. The majority of these participants have formulae that are integrated with Social Security.

A large fraction of defined benefit participants, 43.02 percent, belong to plans that determine benefits independent of earnings. Of this 43.02 percent, 35.61 percent have benefits determined as a flat dollar amount related only to service. The other 7.14 percent receive a flat dollar benefit, independent of earnings or service. Since these formulae provide nominal payments independent of general price or wage increases, they appear completely unindexed with respect to inflation that occurs during the workers' years of service.

Two thirds of plans specifying flat benefits independent of earnings are plans subject to collective bargaining agreements. These plans cover 79.76 percent of participants in plans with flat benefit formulae. Of the 10.07 million union participants subject to these benefit formulae, 3.88 million are members of multi-employer plans. Many of the flat benefit, multi-employer plans appear to be Taft-Hartley plans that combine features both of defined benefit and of defined contribution pensions. For these plans the erosion of real benefits due to inflation during the worker's years of service may be less significant. Under Taft-Hartley plans, employers make defined contributions to a trust that is, typically, jointly managed by the union and the employer. For on-going plans, total payments to beneficiaries are typically determined by contributions to the trust fund and by the fund's investment performance. Trust fund assets are paid out to retired workers over time in the form of flat payments that may or may not be related to service. As additional contributions are made to the fund, its managers periodically may increase the designated dollar benefit amount in their benefit formula. From the perspective of workers as a group, then, many on-going Taft-Hartley plans appear to operate much like defined contribution plans. From the perspective of the individual worker, however, these plans may more closely resemble defined benefit plans than defined contribution plans. This depends on the frequency of increases in benefit amounts. To the extent that revisions in benefit amounts occur infrequently over time, particular workers may be absorbing a substantial inflation risk with respect to the real level of their first benefit check.

Even if individual benefits were adjusted on an annual basis, Taft-Hartley plans may still differ from defined contribution plans. In the case of pension plan termination, Taft-Hartley plans, like standard defined benefit plans, may face legal liabilities that exceed the current value of the plan's trust fund. Vested workers in such circumstances are treated like defined benefit participants rather than defined contribution participants.

The proportion of defined benefit participants covered by non-earnings related benefit formulae rises rapidly with plan size. In plans with 10,000 or more participants, 48.49 percent of participants are covered by such formulae; the corresponding percentage for plans with fewer than 50 covered workers is less than 4. The fraction of defined benefit participants covered by Social Security integrated benefit formulae rises from 31.8 percent for plans with 100 to 250 workers to 38.5 percent for plans with 10,000 or more workers. There is also considerable variation in the use of particular formulae across industries; 68.75 percent of defined benefit participants in finance, insurance, and real estate, but only 5.36 percent of such participants in construction have Social Security integrated formulae.

There seems to be great variation in the rate at which pension benefits replace pre-retirement wages depending on the type of benefit formula in use. Based on 1977 plan provisions, a hypothetical worker retiring in 1977 with 35 years of service and $10,000 in earnings at the end of his or her career would receive, on average, $2,254 among plans specifying the unit benefit formula. This formula computes annual benefits as a fixed percent of a specified earnings base multiplied by years of service. Among plans with formulae specifying a flat benefit related only to service, the benefit would average $3,385.

Replacement rates also vary depending on the participant's salary level. These variations occur chiefly because of plan provisions for Social Security integration. While Internal Revenue Service regulations do not permit qualified pension plans to discriminate in favor of highly paid workers, they do allow plans to integrate their benefit formulae with Social Security in order to counteract Social Security's provision of higher replacement rates for lower paid workes. Other factors held constant, plans with integrated formulae tend to provide higher replacement rates at higher levels of earnings. Among plans with a Social Security offset formula, for example, a hypothetical worker with 35 years of service and a final salary of $40,000 would receive, on average, $15,597, corresponding to a replacement rate of 38.99 percent. If the same worker retired with a final salary of $10,000, however, his (her) benefit would average $2,116, and his (her) replacement rate would be only 21.16 percent.

For plans that do base benefits on earnings, the choice of the earnings base can significantly affect the worker's ultimate replacement rate. Across all earnings-based benefit formulae, the average replacement rate for a 1977 retiree earning $20,000 prior to retirement is 38.85 percent in plans using a final or highest three years earnings base; it is 14.79 percent for plans using a career average earnings base.

The replacement rates for hypothetical 1977 retirees differ significantly across industries. For earnings related formulae, the $20,000 average replacement rate was 18.92 percent in retail trade and 41.91 percent in finance, insurance, and real estate. The $20,000 replacement rate for non-earnings related formulae averaged 11.4 percent in manufacturing, but 21.60 percent in construction.

The replacement rates for hypothetical retirees in non-union plans are larger than those for union plans for earnings related formulae, but smaller for non-earnings related formulae.

These average replacement rates for hypothetical retirees conveniently summarize a number of features of pension benefit formulae and demonstrate the sensitivity of these rates to the level of earnings and choice of earnings base. Whether certain industries or union plans or plans of a particular size, etc., actually provide lower than average replacement rates depends on the joint distribution of earnings, earnings bases, and benefit formulae across these pension plan characteristics. New Department of Labor data, that permits calculation of actual 1978 replacement rates, suggests minor differences in replacement rates by sex, union-status and industry, but considerable differences by the recipient's age at first receipt of pension benefits. Early retirees typically have larger replacement rates than normal retirees reflecting a greater number of years of service with the plan sponsor.

Normal and Early Retirement

Almost 90 percent of pension participants are members of plans that specify a minimum age for normal retirement. This age averages approximately 65. In one quarter of pension plans, covering 45.14 percent of all participants, there is also a service requirement for normal retirement, averaging close to 5 years on a participant-weighted basis. There appears to be relatively little variation in these requirements across plan type, plan size, industry, union status, and plan entity.

A surprisingly large fraction of private plans, 35.9 percent, do not permit early retirement. These plans, however, cover only 17.8 percent of participants. In the case of defined benefit plans only 11.62 percent of participants are completely precluded from early retirement. The typical early retirement age is 56. The typical service requirement for early retirement is about twelve and one-half years and affects over three quarters of covered workers with an early retirement option.

Virtually all private pension participants who retire early may have their benefits specially reduced as a result of retiring early. For over 40 percent of participants, the application of a special benefit reduction depends on the age at early retirement and/or the worker's length of service. For the remaining set of potential retirees, a special benefit reduction is always applied for permissable retirement prior to the plan's normal retirement age.

The plan's normal retirement age certainly demarcates the age beyond which a worker is free to retire and suffer no special benefit reduction. The normal retirement age can also determine the age at which benefit accrual ceases. For close to half of private pension participants, the normal retirement age only serves to make the former distinction; i.e., close to half of private pension participants can continue to accrue pension benefits beyond the plan's normal retirement age. Another 29.75 percent of participants are in plans that permit benefit accrual only until the employee reaches a specified age and/or has completed a specified length of service. The remainder of participants are in plans that permit no additional benefit accrual if the employee continues to work after satisfying the requirements for normal retirement.

Cost of Living Adjustments and Disability Provisions

Cost of living increases appear to be an important feature of many private pension plans. While few plans have provisions for automatic cost of living increases after retirement, most large plans periodically extend ad hoc increases to their retirees. In the period from 1976 to 1979, roughly two-thirds of large private pension plans extended increases averaging 21.88 percent, which is equivalent to roughly half of the rise in the Consumer Price Index over the same period.

Close to three quarters of private pension plans, covering 84.11 percent of participants, provide disability coverage to their workers. The percentage varies across industries, from a high of 93.84 percent in Construction to a low of 67.23 percent in finance, insurance, and real estate. Over two-thirds of participants covered by disability provisions face rather rigorous requirements for receipt of disability benefits. Virtually all of these workers face service requirements to receive disability benefits that average 11.43 years. For a third of workers with disability service requirements, the service requirement is 15 years.

V. Structural Features of State and Local Pension Plans

Participation

In contrast with private pension plans, state and local plans rarely have requirements for participation. In state-administered plans, only 9.05 percent of participants belong to plans that restrict entrance on the basis of age and/or service. The percentage for large city plans is 1.51; it is .61 for other large local plans and 27.48 for small local plans. Where such restrictions arise, the average age and service requirements are similar to those of private plans in the case of small local plans and somewhat smaller in the case of state, city, and other large local plans. While almost one-third of private pension plans prohibit participation of workers beyond a certain age, the comparable fraction for public plans is roughly one-fifth.

The federal government does not regulate state and local pension systems. Unlike private plans, therefore, public plans need not vest workers' benefits. Despite the lack of federal regulation, all state-administered and large city plans as well as all other large local plans in the NBER CLLPS (1978) report vesting provisions. However, almost one third of small local systems covering close to one quarter of all participants in small local plans provide no vesting. On average, state-administered plans require about three fewer years of service for full vesting than do private plans. Large city and other large local plans require roughly an equivalent length of service for full vesting, while those small local plans that permit vesting require, on average, almost four more years of service than private plans. Public pension systems seem to use cliff vesting exclusively. None of the public plans we encountered in this study reported gradual or "graded" vesting.

Benefit Provisions

Virtually all state and local pension plans are defined benefit plans. However some of these plans provide additional defined contribution benefits based on special employee contributions. Relatively few of the benefit formulae in the public defined benefit plans are integrated with Social Security. In the case of state-administered plans, for example, only 15.60 percent of participants are enrolled in integrated plans. For large city plans the percentage is 27.64; it is 5.36 for other large public systems and 7.80 for small local systems. For private plans the percentage is 37.57. Part of the explanation for this difference is simply that many state and local workers are not covered by Social Security. In 1980, approximately 37 percent of state-administered pension participants and 51 percent of large city pension and other large local pension participants were not covered by Social Security at their public sector job.

All public defined benefit plans surveyed in this book use past earnings to compute retirement benefits. State systems rely to a great extent on the unit benefit formula that determines benefits as a fixed percentage of a specified earnings base multiplied by the length of service. Almost two-thirds of state-administered pension plan participants are covered by this formula. The fraction is also quite large -- 80.53 percent -- for large local plans, other than large city plans.

The substantial use of terminal years' earnings in computing the defined benefit earnings base significantly reduces the sensitivity of real public pension benefits to inflation that occurs during a worker's years of service. For over 80 percent of public pension participants, the earnings base is determined as the average of the highest five final years of earnings. In the case of private plans, over one quarter of the 43.50 percent of defined benefit participants with earnings-based benefits receive pensions based on a career average of earnings.

Public pension plans appear to offer much more generous pension benefits than private plans. In the case of state-administered plans, for example, a hypothetical worker retiring in 1977 with a final salary of $20,000 would receive an annual benefit equal to 57.00 percent of his or her final salary. In the case of private defined benefit plans the average earnings-related benefit replacement rate for a $20,000, 1977 retiree is only 29.39 percent. The proposition that public pensions are more generous than private pensions is supported by 1980 Current Population Survey data indicating average benefits of $3,850 for 65 to 69-year-old male private pension recipients, but $4,654 for the corresponding state and local pension recipients. For female recipients in this age group, private benefits average $1,789, compared with public benefits for females of $3,850. Pension benefits constitute less than 30 percent of the total income of private recipients. In contrast, public pension recipients in this age group receive roughly 40 percent of their income from pensions.

Normal and Early Retirement

Over 85 percent of all public systems and 100 percent of state-administered systems and other large local plans in the NBER CLLPS (1978) survey specify an age requirement for normal retirement. For state, large city, other large local, and small local plans, the participant-weighted normal retirement ages average 60.11, 58.75, 62.44, and 62.55 respectively. The average normal retirement age for private plans is 64.71. Over half of public pension participants must satisfy service as well as age requirements to qualify for normal retirement. These service requirements average 10.10, 11.25, 14.15, and 15.09 years for state, large city, other large local and small local systems respectively. In the case of large city and small local plans, 9.09 and 13.16 percent of participants, respectively, face only a service requirement to qualify for receipt of normal retirement benefits. For both types of systems the average service requirement is 20 years.

With the exception of small local plans, the vast majority of public pension participants belong to plans with provisions for early retirement; 96.54 percent of state participants, 66.16 of large city participants, 85.82 percent of other large local participants, but only 51.54 percent of small local participants have early retirement options. In the case of private pensions, 82.20 percent of participants are covered by early retirement provisions. For all four public pension groups the mean (participant weighted) early retirement age, when one is specified, is roughly 54. The mean (participant weighted) service requirement of plans specifying a service requirement ranges from .51 years in state plans to 1.23 years in small local plans. In private plans the early retirement age averages 56, while the mean service requirement is about 12 years.

VI. Financial Status of Private, State, and Local Pension Systems

Pension funds and pension reserves of insurance companies represent a growing repository of national savings. The 1980 value of these savings was $650.7 billion, or 6 percent of total 1980 private sector net worth. Private pensions accounted for 69.24 percent of these assets. The current and future pension benefits that must be financed in part by these assets are equally sizeable. For example in 1980, 497 of the nation's largest corporations reported vested accrued liabilities of $137.10 billion. Estimates of 1978 vested accrued state and local pension liabilities range from 135.6 billion (assuming a 12% interest rate) to 179.2 billion (assuming an 8% interest rate).

Measurement of these and other liability concepts is highly sensitive to the choice of interest rate used to discount future benefit streams, to projected rates of employee wage growth, and to assumptions about worker longevity and employment separation. Even if measurement were straightforward, there would still be major conceptual questions concerning the appropriate definition of pension liabilities. Two definitions considered in this book are accrued and projected liabilities. Accrued liabilities are essentially "shutdown" liabilities. They equal benefit obligations a plan would face if it terminated operation and paid off vested and, in the case of total accrued liabilities, unvested benefits using only past service and past levels of earnings to compute benefits. Projected liabilities equal the present expected value of benefit payments payable to current participants assuming the plan continues in operation, and that service and earnings of active participants increase at projected rates. Projected liabilities look to the future, while accrued liabilities are based solely on past experience.

The vested accrued liability concept may be most appealing to members of the legal profession, since it corresponds most closely to an enforceable legal claim. However, in certain circumstances, unvested accrued benefits also represent legal liabilities of the pension fund. Under ERISA, unvested accrued liabilities are residual claims on a terminating private plan, provided that plan assets exceed the plan's vested accrued liabilities. Total and vested accrued liabilities are currently reported by most major corporations in accordance with the 1980 recommendation of the Financial Accounting Standard Board.

Actuaries often consider legal definitions of pension liabilities too narrow for purposes of judging the appropriate degree of pension funding or the true economic claim on plan sponsors. Legal pension claims - vested accrued benefits and, potentially, unvested accrued benefits -are paid, in practice, only in the case of plan termination. For on-going pension plans that provide rapid growth in pension benefits as the worker accumulates more service and/or earns a larger wage, the assets required to fund projected liabilities will exceed those required to fund accrued liabilities based on past service and earnings experience.

Economists also find projected liability concepts interesting. For on-going plans, projected benefits may represent implicit, if not legal claims on plan sponsors. Contractual models of labor market behavior view workers and employers as entering into long-term agreements in which the worker provides a time path of labor services in exchange for a time path of total compensation. Within these models there need be little or no relationship between this year's labor effort and this year's compensation. For example, young workers who consider joining a particular firm will consider the firm's projected pension benefit offer as well as its projected path of non-pension compensation in making their decision. In contrast with this contractual view of labor markets, traditional spot labor market theories predict that new hires consider only their immediate wage and accrued pension compensation. For young workers covered by plans with long service requirements for vesting, the value of immediate pension accrual may be zero. Hence, in the context of contractual labor markets, projected pension benefits simply represent one component of the employer's long-term compensation obligation, and projected rather than accrued liabilities are most relevent for considering the interactions of pensions and economic behavior.

Another example of the economic importance of projected, as opposed to accrued liabilities, involves the financial valuation of the plan sponsor's enterprise. If employers have effectively committed themselves to a long-term level of worker compensation including projected pension benefits, then it is projected rather than accrued unfunded liabilities that represent a claim on the plan sponsor's non-pension assets and future profits.

In contractual labor markets, a comparison of projected pension liabilities with pension fund assets may provide little informatin about potential pension default. By assumption, the employer is committed to meeting all explicit and implicit compensation committments. Hence, if pension fund assets are inadequate to meet projected pension liabilities, the firm will use its other assets to cover the difference. Therefore, while the size of unfunded projected pension liabilities is not necessarily indicative of the probability of default, it does indicate the size of the implicit lien on the employer's non-pension assets.

Choice of an appropriate pension liability concept is also an important problem for government officials charged with oversight of pension tax treatment. Contributions to pension funds are deductible by the employer and, therefore, reduce the employer's current corporate or personal income tax liability. Excess contributions to pension funds are a potential mechanism for deferring taxation of the employer's profits. Such excess contributions defer rather than eliminate tax liabilities because future repatriation of excess assets from the pension fund to the employer are taxable to the employer. Another tax advantage of pension funds that may lead to overfunding relative to a reasonable, although not necessarily legal, standard is that capital income on pension fund investments accumulates free of tax. One way in which plan sponsors might attempt to minimize their tax liabilities is to borrow money to fully fund or, if possible, overfund their true underlying pension liabilities. Assuming these funds can be invested at rates comparable to those at which the initial loan is secured, the plan sponsor receives interest deductions on corporate or personal taxable income, but receives interest, or other forms of capital income, tax free through the pension fund. The extent to which this type of tax avoidance occurs is poorly understood, as is the potential for repatriation of excess assets from the pension trust fund.

If one considers vested accrued liabilities as the relevant measure of pension indebtedness, then the majority of pension plans of major U.S. corporations appear to be adequately funded, if not over funded, according to their own official reports. The 1980 annual reports of 497 of the Fortune 1,000 largest U.S. corporations include estimates of total accrued and vested accrued pension liabilities. They also list the 1980 market value of pension fund assets available to meet these liabilities. Across all 497 corporations vested accrued liabilities totaled $137.10 billion while pension fund assets equaled $133.3 billion. For over half of these corporations, pension fund assets exceed vested accrued liabilities. Fifteen corporations reported assets that were twice the value of their vested accrued liabilities. Only 7 of the 497 corporations had assets representing less than 50 percent of their vested accrued liabilities, and two of these corporations have only recently established their pension plans.

General Motors and Chrysler rank first and second in terms of largest 1980 unfunded vested accrued liabilities. These unfunded liabilities are $4.08 and $1.28 billion respectively. General Motor's $13.35 billion of assets represent, however, 77 percent of its $17.44 billion vested accrued liabilities.

Chrysler's $1.75 billion pension assets, on the other hand, are only 58 percent of its $3.02 billion vested accrued liability. In this sample the corporation with the largest excess of assets over vested accrued liabilities is Western Electric with a $1.67 billion vested accrued pension surplus. To place these figures in some perspective, Chrysler's 1980 unfunded vested liability per employee is $9,566; Western Electric's corresponding surplus per employee is $9,435.

While the 1980 corporate annual reports do not report projected liabilities, a rough sense of the relationship between projected and accrued liabilities may be obtained by comparing this volume's estimates of these two liability concepts in the case of state and local pension plans. For state-administered, large city, other large local, and small local plans the ratios of projected to vested accrued liabilities are 2.35, 1.78, 2.13, and 2.70 respectively, discounting at a 12 percent nominal rate. Using an 8 percent nominal rate these ratios are 2.23, 1.77, 2.06, and 2.51 respectively. Application of the highest and lowest of these ratios, 2.70 and 1.77, to the $137.10 billion vested accrued liabilties of the 497 corporations in the NBER Fortune 1,000 samples leads to projected liability estimates ranging from $370.17 billion to $242.67 billion for these companies. The corresponding range of estimates of unfunded projected liabilities is $236.87 billion to $109.37 billion. Under the assumption that projected liabilities for these corporations are twice vested accrued liabilities as many as 231 of the 497 corporations may be less than 50 percent funded with respect to projected liabilities.

Appraisal of the financial condition of state and local pension plans is also highly dependent on the definition of pension liabilities and the method used to measure these liabilities. *Pensions in the American Economy* presents estimates of accrued (total and vested) and projected liabilities for different long-term rates of inflation. Nominal interest rates are assumed to rise point for point with inflation. The nominal interest rate is taken to equal a 3 percent real rate plus the assumed rate of inflation. This assumption in conjunction with actual non-indexed state and local benefit formulae as well as less than complete cost of living adjustments of recipient's benefits makes liability estimates highly sensitive to inflation.

For 1978, the estimated value of total accrued liabilities of state-administered pension plans is $137.84 billion calculated using an 8 percent interest rate. Use of a 12 percent interest rate lowers the estimate of these liabilities to $100.43 billion. The 1978 value of total state pension assets equalled $125.18 billion, 90.81 perdent of the 8 percent liability, but 124.64 percent of the 12 percent liability. As a group, then, state pensions are more than fully funded assuming a 12 percent interest rate and over 90 percent funded assuming an 8 percent interest rate.

In general large city pension systems and other large local systems are somewhat less well funded with respect to total accrued liabilities than are state plans. In 1979 the twenty cities with the largest number of pension participants reported combined assets of $20.34 billion dollars. These assets represented 67.50 percent and 83.39 percent of large city total accrued liabilities, calculated at 8 and 12 percent interest rates respectively. For other large local pension plans, combined 1979 assets of $3.17 billion covered 74.96

percent and 98.23 percent of total accrued liabilities at respective interest rates of 8 and 12 percent.

Small local plans, as a group, are much more poorly funded than the other public pension systems. Assuming an 8 percent interest rate a random sample of public pension plans with 500 or fewer participants are 47.23 percent unfunded with respect to total accrued liabilities; they are 63.91 percent unfunded using a 12 percent interest rate.

While public pension plans in the aggregate appear fairly well funded in terms of total accrued liabilities, there is considerable heterogeneity across pension plans. Based on an 8 percent interest rate, for example, 7 state plans are less than 50 percent funded with respect to total accured liabilities; 12 states have funding ratios between .5 and .75, 18 states fall between .75 and 1, and 13 states are more than fully funded. The corresponding funding ratios for large cities range from essentially zero in the case of Indianapolis to 1.61 in the case of Milwaukee. For other large local plans and small local plans the dispersion in funding rates of accrued liabilities is equally significant. Part of this dispersion may, however, reflect the assumption of a uniform age wage service distribution in these actuarial calculations.

The financial condition of public employee pension systems appears much poorer from the perspective of projected liabilities. In contrast to a $137.84 billion total accrued liability at an 8 percent interest rate, the 1978 projected liability of state plans computed at the same interest rate is $294.87 billion. State pension assets in 1978 of $125.18 billion represented less than 43 percent of projected liabilities. For large city plans, projected liabilities exceed total accrued liabilities by a factor of 1.36 under both 8 and 12 percent interest rate assumptions. Similar ratios apply for other large local and small local pension systems. Under the projected liability definition of pension obligations, 74.00 percent of state plans, 52.27 percent of large city plans, and 75.89 percent of other large local plans are less than 50 percent funded assuming an 8 percent interest rate.

Senator NICKLES. Thank you very much. You mentioned in your statement that pension beneficiaries suffer real losses or gains inversely with employers' losses or gains. Could you explain that further?

Dr. KOTLIKOFF. The research that I conducted suggests that real pension benefits are highly sensitive to inflation, particularly in defined benefit plans. When the inflation rate goes up, nominal interest rates tend to rise; this increase means that covered workers may suffer capital losses on their previously accumulated pension benefits because those benefits are not indexed, that is, the present expected value of the pension benefit obligations to the employer declines.

So, basically, if the worker is getting a dollar less in real terms because of inflation, that means the employer is having to pay a dollar less.

Senator NICKLES. And you are talking about a defined benefit plan?

Dr. KOTLIKOFF. Yes; in a defined benefit plan.

Senator NICKLES. Let me explore that because I do not know if I quite agree with you. Granted, inflation may erode the value, but is inflation not also increasing the value of his compensation? Therefore you would be moving in tandem together, if it is final average compensation, which most defined benefit plans are?

Dr. KOTLIKOFF. There are two aspects to the inflation sensitivity of real pension benefits. One is the fact that there are fairly limited cost-of-living adjustments for beneficiaries after they do retire.

Senator NICKLES. OK, so you are just talking about post-retirement?

Dr. KOTLIKOFF. Well, that is one aspect. Let me just say that the data I have looked at suggests that between the period 1973 to 1979, for typical recipients who were retired and already receiving benefits, the cost of living increased by 63 percent during that period and the mean cost-of-living adjustment of pension benefits was about 28 percent, suggesting a real reduction in pension benefits of about 21 percent over this period.

Senator NICKLES. Again, you are talking about post-retirement.

Dr. KOTLIKOFF. Yes; but now let me turn to pre-retirement. About 27 percent of active pension participants are in plans that specify benefit formulas—these are defined benefit participants—that potentially make the real level of the first year's pension benefit quite risky to inflation occurring during the participant's working years.

One example is a defined benefit plan that computes the worker's pension on the basis of a lifetime average of nominal earnings. In other words, there are earnings-based formulas which are not just final year or final 5 years. A significant fraction of those earnings-based formulas are career average and 10-year averages.

In addition, something like——

Senator NICKLES. I can see that an argument can be made if there are no inflation adjustments post-retirement. But, pre-retirement, I would say that it would be working in the employee's advantage, not in the employer's advantage.

Dr. KOTLIKOFF. Well, let me try and be a little more explicit. Suppose I am in a plan that bases my pension benefit on my career average and I started working for the plan at age 30 and I am now age 50 and there is a big increase in inflation.

Now, when I hit age, let us say, 65——

Senator NICKLES. You said a career average?

Dr. KOTLIKOFF. Yes; a career average.

Senator NICKLES. So, they are going to average throughout the——

Dr. KOTLIKOFF. They are going to average starting at age 30.

Senator NICKLES. Do you know how many plans have that type of a base?

Dr. KOTLIKOFF. Well, there is a significant fraction. I do not have the numbers precisely at hand, but a substantial fraction of participants in defined benefit plans are covered by earnings bases which are longer than 5 years.

Senator NICKLES. I have not heard of many career-based.

Dr. KOTLIKOFF. Yes. This is one of the surprising findings of our research.

Senator NICKLES. If you have information which tells you how many have that long a period, I would be interested in it. Here, again, my familiarization with it has been for the shorter time.

Dr. KOTLIKOFF. Let me also add that in addition to these earnings-based formulas, about 43 percent of defined-benefit participants are enrolled in plans which specify benefits that are completed unrelated to earnings.

For example, you could have a plan that specifies a flat dollar amount times years of service. So, 43 percent of defined benefit participants are in plans that have benefit formulas that have nothing at all to do with earnings.

Now, it seems to be the case that these plans typically readjust their benefit formulas from period to period, from year to year or maybe every 3 years. We do not really have very good data on how often these adjustments occur.

Senator NICKLES. Again, I am interested in this because I do not quite agree with your assumption that a gain for the employee is a loss for the employer, or vice versa.

When they are renegotiated, rewritten or adjusted, is that usually to the benefit of both parties or, in contrast, is somebody a winner and somebody a loser?

Dr. KOTLIKOFF. Well, that is one thing we really do not have good data on. First of all, we do not have good data on how often these formulas are adjusted.

Senator NICKLES. Have you ever heard of negotiations where there have been significant reductions in pension benefits?

Dr. KOTLIKOFF. Significant reductions or significant increases in the——

Senator NICKLES. I am still wrestling with the idea of bargaining or negotiations and you are talking about a defined-contribution plan. Somebody would roll back and have a smaller contribution; or in a defined-benefit plan, if they were paying a certain percentage of base, that has been reduced. It is usually ratcheted in one direction, not necessarily in the reverse.

With the economy being like it is, there have been some renegotiations and maybe that has taken place. But for the most part, I think it has been on an upward trend, not on a downward trend.

Dr. KOTLIKOFF. I think it probably has been. We just really do not have data. It is very important to collect this data.

Let me give the extreme example of the worker in such plan bearing all the inflation risk. Suppose I am in a plan which specifies so many dollars per month of service, and let us just use, for sake of argument, a number of $100 per month of service. And now there is a big increase in inflation of the sort we observed in the seventies, and we sit down and renegotiate my pension plan.

Well, it could be that I get a higher nominal dollar amount associated with this formula, but that I pay for that in the form of a lower amount of straight wages. So, exactly who is bearing this risk, whether it is the worker or the employer, is still an open question and would not really be resolved by just looking at the fact that there were periodic revisions.

One has to look at whether the total compensation accruing to workers, including straight wages, is not adversely affected by inflation.

Senator NICKLES. Doctor, thank you very much for your comments.

Our next panelist is Donald Kirk, chairman of the board of the Financial Accounting Standards Board. Welcome.

STATEMENT OF DONALD J. KIRK, CHAIRMAN, FINANCIAL ACCOUNTING STANDARDS BOARD, STAMFORD, CONN., ACCOMPANIED BY TIMOTHY LUCAS, STAFF MEMBER, FINANCIAL ACCOUNTING STANDARDS BOARD

Mr. KIRK. Good morning, Mr. Chairman. I am Donald J. Kirk, chairman of the Financial Accounting Standards Board. With me is Timothy Lucas, the FASB staff member responsible for the pensions project.

The subcommittee's hearing today is addressing the health and future of private pension plans. Though the subject encompasses matters far beyond accounting, accounting has a role to play. Assessing the health of pension plans requires measuring financial items, such as the obligation for benefits promised and the amounts of pension assets. Those measurements bring the discussion into the realm of accounting.

In fact, some have argued that changes in pension accounting might directly affect the health or even the future of pension plans. They believe that the requirement to report certain information could influence decisions on funding, or even cause an employer to decide to discontinue his plan.

I know Members of Congress are receiving copies of letters addressed to me claiming that a recent board proposal could have those effects.

The Financial Accounting Standards Board is recognized by the Securities and Exchange Commission and the accounting profession as the authoritative body to establish standards for financial reporting. Those standards define the financial statements and other financial information presented in reports, such as corporate annual reports, that are used by investors, creditors and others outside a business enterprise.

Those who use financial reports simply must have reliable and understandable information about the cost of pensions and the extent of a company's pension obligations. The significance of pensions for many employers is such that they cannot be ignored.

It is difficult to argue, in my view that the public interest would be served by allowing that information to be withheld from financial statement users.

As you have undoubtedly observed, there is a great deal of complexity, misunderstanding, and more than a little mystery surrounding today's pension arrangements. The FASB has been studying pension accounting questions for almost 9 years, searching for improved ways of presenting meaningful and understandable information about the status of pension plans. We believe we have made progress in penetrating the mystery and improving communication of financial information about pensions, but the job is not yet finished.

Progress has been made in providing cost effective, comparable and understandable information in the financial statements of pension plans. Progress has also been made in improving pension information disclosed in the notes to employers' financial statements.

Those steps were put in place in 1980. The evidence available at that time, especially that provided by knowledgeable representatives of financial statement users, convinced the board that the progress to date was not enough. The board concluded it should also reconsider the accounting rules for measuring and reporting pension cost and pension obligations in employers' financial statements.

It is those rules that are addressed in our current project on employers' accounting for pensions. As the latest step in that project, the board recently published its "Preliminary Views," a copy of which is included in the material we have submitted.

The board has expressed the view that some changes in pension accounting are desirable. Those changes include uniform use of a measurement method that is based on the terms of the pension plan. They also include recognition in the employer's balance sheet of the unfunded obligation for benefits based on employee service already rendered. Those changes are discussed in more detail in the summary at the beginning of the "Preliminary Views" document.

Those possible changes have already proved controversial, but the board believes there is a need for improvement in pension accounting. However, no changes will be made without careful consideration of as many views and as much information as the board can obtain.

Much remains to be done before any change is finally implemented. A document requesting comment on additional issues will be published shortly, and the board will hold another public hearing this fall. We have also prepared a data bank of pension disclosures by more than 1,200 companies.

An exposure draft of our proposed statement will be issued for public comment probably in 1984, and after those comments are assessed, a final statement is expected sometime in 1985.

The board is working with the Financial Executives Institute in conducting a field test of the proposed changes contained in our preliminary views. All of these procedures are intended to insure that the board is aware of all relevant facts and has the opportunity to understand and consider various points of view before making a decision.

We appreciate the interest of the committee in the work of the board and we stand ready to assist you in any way we can.

[The prepared statement of Mr. Kirk, with attachments, follows:]

STATEMENT
OF
DONALD J. KIRK
CHAIRMAN OF THE
FINANCIAL ACCOUNTING STANDARDS BOARD
BEFORE THE SUBCOMMITTEE ON LABOR OF THE
COMMITTEE ON LABOR AND HUMAN RESOURCES
UNITED STATES SENATE
MARCH 21, 1983

Background About FASB

The FASB has been the recognized accounting standard-setting body in the United States since 1973. The FASB is an independent, seven-member board that operates under the oversight of a private foundation (the Financial Accounting Foundation) sponsored by six national organizations representing accounting academicians, certified public accountants, securities analysts and investment advisors, corporate financial executives, management accountants, and investment bankers and brokers.

Statements of Financial Accounting Standards issued by the FASB establish new standards of financial accounting and reporting or amend those previously issued. Collectively, those standards reflect the continuing process of establishing and maintaining "generally accepted accounting principles" (GAAP) in the United States. FASB standards are officially recognized as authoritative by the Securities and Exchange Commission (Financial Reporting Release No. 1, Section 101). They are recognized under the code of ethics of the American Institute of Certified Public Accountants and under the CPA licensing statutes, regulations, or practices of the 50 states. Further information about the FASB is contained in the attached "Description and Background" and "Relationships with the Federal Government."

The Hearings

The subcommittee's hearings are addressing the health and future of private pension plans. That is clearly a broad subject that encompasses matters far beyond accounting. But the subject of accounting has a role to play. A discussion of the health of a pension plan, or of all pension plans, cannot proceed very far without involving quantification (i.e., measurement) of financial items such as the amount of the obligation for benefits and the amount of pension assets. Those measurements of financial quantities bring the discussion into the realm of accounting.

We hope and expect that the information gathered by the FASB and the insights gained in studying pension accounting issues over the last several years will be useful to the subcommittee.

The Need for Relevant and Reliable Pension Data

As indicated by its name, the FASB is primarily concerned with financial statements and other financial information presented in reports used by investors, credit grantors, government, and others outside a business enterprise. Those external decision-makers need information that enables them to assess the financial condition of the enterprise (its resources and obligations) and its performance (including its revenues, expenses, earnings, and cash flows). These are the considerations that have guided the Board's deliberations on pensions.

The current FASB project on Employers' Accounting for Pensions is one of the Board's most important undertakings since the Board was established in 1973. It is important because retirement plans have become significant to individuals, employers, and to our nation's economic and social structure as a whole. As a result, it is essential that accounting provide information about employers' pension costs and pension obligations that is relevant, reliable, and understandable; in a word--useful.

Sound pension reporting is essential at the microeconomic level because of the magnitude of investment and credit decisions that are made in reliance on financial reports. People who decide to buy and sell shares of stock of companies that sponsor pension plans, people who decide whether to grant credit and on what terms, and people involved in regulation of economic activities all need reliable information about the cost of pensions and the extent of a company's pension obligations.

Good pension accounting is also important for macroeconomic decision making. Understanding the nature of pension costs and liabilities is important to legislators and other government officials who make decisions based on macroeconomic data.

The relationship between accounting and the decisions described above means that good accounting in general is important to society as a whole rather than only to accountants. Good accounting (by which we mean accounting that provides relevant, reliable, and understandable information) can contribute to improved decisions made by those who use the information. Conversely, accounting that misleads or misinforms can contribute to decisions that have adverse consequences for all.

Funding of and Accounting for Pension Plans

When a company sponsors a pension plan, it incurs an obligation to provide for the promised benefits. The measurement of that obligation and the related cost affect the company's income as reported in the annual report to shareholders. A company may also have funded part or all of its obligation by contributing assets to the plan. People who use the company's financial reports need to know about both pension cost and pension obligations as well as the amount of funds set aside to provide for benefits. The role of financial accounting is to provide that needed information. To fill that role, the accountant, with the actuary's help, must determine or measure the amount of pension cost and the amount of the obligation for benefits.

The actuary, on the other hand, is primarily concerned with advising the employer on how to fund the pension obligation, that is, with establishing the amounts and timing of the contributions that will provide benefits to plan participants. The minimum funding standard of ERISA most directly affects actuaries and employers. However, in seeking to understand the various factors that impact funding decisions, you will hear about accounting information and the confusion that exists, even among accountants and actuaries, between accounting and funding.

Both the accounting for pensions and the funding decision require estimates of future events that affect the amount of benefits that will actually be paid to retirees. For both purposes one must estimate how many employees will survive to retirement age; the amount of benefits they will receive, and how long they will live to collect benefits thereafter, to mention just three. These estimates or assumptions are made by the actuary for both funding and accounting purposes.

Using the assumptions, there are two separate questions to be answered. First, the accounting question is, how much pension cost and pension obligation have been incurred? Second, the funding question is, how much money should be set aside each year to provide for the ultimate benefit payments? The actuary may use any of a number of methods to establish a funding schedule or budget. Some methods set aside relatively less now and make up for it with relatively larger amounts in later years. Others schedule approximately level amounts or level percentages of compensation in all years. The choice of funding methods is essentially a financing question. It is affected by many factors including the financial condition of the employer and the plan, available cash flows and other investment opportunities or needs, and legal requirements. It has been argued that the employer and the actuary need flexibility, at least within reasonable limits, in order to arrive at suitable funding schedules in different circumstances.

There is no compelling reason why all companies should fund exactly the amount of pension cost incurred each year. Some may choose to fund more and others less within applicable legal limits. Even though considerations of retirement income security and tax policy have led to some regulation of the funding, a considerable range of discretion is usually available for funding decisions. But the amount of cost attributable to employees' services rendered to date and extent of the obligation incurred--whether or not funded--are important information that is a necessary part of financial reports. Credible financial accounting requires that like situations be reported similarly and that differences between situations be reflected.

Under current accounting, employers may use any of a number of actuarial cost methods to determine the amount of the pension cost to be recognized for a period. Many employers use the same method to determine pension cost as they use for funding the pension plan.

The similarity of the basic problems tends to obscure an important distinction between funding and accounting. Similar calculations are involved, but each is guided by a different objective. The accounting objective is to provide information that informs investors, creditors, and other external parties about the amounts of pension cost and obligation incurred, as well as the amounts funded. To be useful for purposes of making rational economic decisions, financial reporting information must be consistently determined from one period to the next and, to the extent possible should be comparable among business entities. Hence, the financial reporting objectives are better served by a narrower rather than a broader choice of methods, so that companies with similar plans (and thus, similar costs and obligations) do not report different results simply because they use different accounting methods.

FASB's Pension Projects

The following is a brief background description of the FASB's progress and involvement to date in the pensions area. The Board has published two Statements of Financial Accounting Standards, Statements No. 35, Accounting and Reporting by Defined Benefit Pension Plans, and 36, Disclosure of Pension Information, as well as several other background publications. Statements 35 and 36 were issued following five years of study and deliberation, including cooperative efforts among the Board, the Department of Labor, and the American Academy of Actuaries.

Statement 35

Statement 35 was issued in March 1980. The Statement establishes for the first time standards of accounting applicable to the financial statements of the pension plan itself. An auditor's opinion on whether pension plan financial statements have been prepared in accordance with generally accepted accounting principles is required in certain circumstances by ERISA.

Statement 35 states that the primary objective of a pension plan's financial statements is to provide financial information that is useful in assessing a plan's present and future ability to pay benefits when due. To meet that objective, the financial statements of the plan are required to contain information about plan assets available for benefits and about the benefits that have been earned by participants based on their service to date.

Statement 35 requires that plan investments be measured at "fair value," equivalent to market value where available. The Board believes that basis provides the most relevant information about the resources of a plan consistent with the primary objective of the financial statements. Benefit information includes the actuarial present value of employees' vested benefits and employees' nonvested benefits expected to become vested. That aggregate amount is referred to as the actuarial present value of accumulated plan benefits. Accumulated plan benefits represent those future benefit payments expected to be paid under the terms of the plan based on employees' service and compensation to date.

Statement 36

Statement 36 was issued in May 1980. That Statement mandates certain new pension disclosures in employers' financial statements. Statement 36 requires employers to disclose in the notes to their financial statements, plan asset and benefit information determined in accordance with Statement 35. As a result, employers' disclosures about plan assets and obligations computed using a comparable methodology are now being presented in the notes to the employer's financial statements, although the pension cost recognized in the financial statements is still computed using a variety of different methods. Statement 36 is an interim solution designed to improve the usefulness of employers' pension disclosures pending completion of the Board's current project, which is a comprehensive reexamination of the accounting and disclosure requirements for financial statements of employers that sponsor pension plans.

Pension Information

In connection with the ongoing consideration of pension matters, the staffs of the FASB and the American Institute of Certified Public Accountants published a book in 1981 that illustrates and analyzes the disclosures of the pension information provided by Statement 36. The purpose of the book was to provide good examples of the application of Statement 36 to encourage further improvements in corporate pension disclosure practices.

The FASB has also prepared a computerized data bank of the Statement 36 disclosure information in cooperation with the Accounting Research Center of Columbia University Graduate School of Business. The data bank was created to facilitate research on pension information. The data bank includes pension disclosure information extracted from the financial reports of approximately 1,300 companies. The information is available to researchers in several different machine readable forms, each with appropriate documentation.

Employers' Accounting for Pensions

The Board's current project, employers' accounting for pensions, is a long-range undertaking to reconsider accounting rules for measuring and reporting pension expense and pension obligations in the financial statements of employers. Completion of that project is several years away. The Board has an extensive due process procedure for all major projects--more extensive, even, than that required by the Administrative Procedure Act. At each stage in the process the Board seeks and considers comments from all interested parties. Public hearings are held. In addition, meetings of the Board at which accounting issues are deliberated are open to the public. Those procedures are intended to ensure that the Board is aware of all relevant facts and has the opportunity to understand and consider various points of view before making a decision. In the case of employers' accounting for pensions, the points of view that have been advanced are not only varied, they are also, in some cases, quite strongly held.

One result of the Board's approach to due process is that major projects tend to take quite a long time to complete. Another result is that there may be a great deal of spirited public debate during the period that a project is being considered. In some cases, including the pensions project, parties to that debate have predicted dire consequences if a particular accounting approach were to be adopted. The Board is sensitive to the possibility that changes in accounting might have unintended adverse consequences for some members of society. It makes every effort to evaluate such arguments and, where possible, to mitigate adverse consequences. In general, however, the Board believes that the importance of providing information to users of financial reports is great. In other words, information that would be reliable and relevant to decision makers should not generally be omitted from financial reports on the basis that decisions made using the information might be undesirable from the point of view of a particular party. The Board believes that accounting information should be neutral in that it is not intended to produce a predetermined result or favor one interest over another. To be neutral, accounting information must report economic activity as faithfully and completely as possible without coloring the image it communicates for the purpose of influencing behavior in some particular direction.

For major technical projects, the Board also seeks the counsel of a task force of people who are knowledgeable about the specific areas involved. The Board's task force on employers' accounting for pensions is made up of individuals from academe, the financial community, government, industry, and the public accounting and actuarial professions.

On February 19, 1981, the FASB issued a Discussion Memorandum, Employers' Accounting for Pensions and Other Postemployment Benefits. That memorandum analyzes and requests comment on the basic issues related to pension accounting and reporting. The Discussion Memorandum does not take a position on the issues but discusses both pros and cons to help those who wish to comment understand the issues posed and develop their positions. The Board received approximately 200 letters of comment on the Discussion Memorandum.

The Board held a public hearing in July of 1981 and began Board deliberations in September of 1981. After careful consideration and deliberation extending over 25 public Board meetings, the Board issued in November of 1982 a document called Preliminary Views, a copy of which is attached. That document presents the Board's views on certain major pension accounting issues for further consideration and discussion. It includes a proposal for certain changes in employers' accounting for pensions.

The Board is conducting a field test of the proposed accounting in cooperation with The Financial Executives Institute. The companies participating in the field test will apply the accounting proposed in Preliminary Views to their actual situations and share the results with the FASB. The test is expected to help the Board assess the impact on financial statements of Preliminary Views and identify implementation problems.

Neither the Discussion Memorandum nor the Preliminary Views deals with the whole range of pension accounting issues. Both of those documents concentrate on single-employer, defined-benefit pension plans in the United States that are noncontributory and are not funded through contracts with insurance companies. Situations in which the employer is not a going concern or the plan may be terminated and similar events are not addressed.

Accounting for those situations and other types of plans must be considered before any change is implemented. Those additional issues are a part of the project and will be discussed in another document to be issued by the Board shortly. That document includes discussion of issues related to:

a. multiemployer plans
b. foreign plans
c. plans funded using contracts with insurance companies
d. defined contribution plans
e. plans that may be terminated and situations in which the employer is not a going concern
f. plans that are curtailed (for example, when a plant is closed)

The soon-to-be-issued second discussion document will request additional input from all interested parties. The Board has not yet deliberated those issues or arrived at a position on them.

After the Board considers the responses (comment letters and presentations at the public hearing) to Preliminary Views and the second discussion document, and the results of the field test, the Board intends to issue an Exposure Draft of a Statement of Financial Accounting Standards that addresses all pension arrangements. The Exposure Draft is not expected to be issued before 1984. There will be an additional comment period on the Exposure Draft before the Board considers issuing a final Statement.

The Board's objective in the pensions project is to provide better, that is, more useful, information about pensions in financial reports. As indicated by the Preliminary Views document, the Board has tentatively reached the conclusion that some changes in pension accounting are desirable. Those changes include a comparable measure of the pension cost and obligation based on the terms of the pension plan formula and recognition in the employer's balance sheet of the net pension liability (or asset). Those changes are discussed in more detail in the summary at the beginning of the Preliminary Views document.

Those changes will not, however, be made without careful consideration of as many views and as much information as the Board can obtain. Much remains to be done before any change is implemented. We appreciate the interest of the committee in the work of the FASB and we stand ready to assist you in any way we can.

FACTS about FASB

Financial Accounting Standards Board • High Ridge Park, P.O. 3821, Stamford, Connecticut 06905-0821

DESCRIPTION AND BACKGROUND

Since 1973, the Financial Accounting Standards Board has been the designated organization in the private sector for establishing standards of financial accounting and reporting. Those standards are, in effect, rules governing the preparation of financial reports. They are officially recognized as authoritative by the Securities and Exchange Commission (Financial Reporting Release No. 1, Section 101) and the American Institute of Certified Public Accountants (Rules of Conduct, as amended May 1973 and May 1979).

The SEC has statutory authority to establish financial accounting and reporting standards under the Securities Exchange Act of 1934. Throughout its history, however, the Commission's policy has been to rely on the private sector for this function to the extent that the private sector demonstrates ability to fulfill the responsibility in the public interest. The FASB was conceived by a special study group headed by a former SEC Commissioner and was carefully designed to carry out this responsibility.

The seven members of the Financial Accounting Standards Board serve full time. They have diverse backgrounds, but they must possess "knowledge of accounting, finance, and business, and a concern for the public interest in matters of financial accounting and reporting." Board members are appointed for five-year terms and are eligible for reappointment to one additional five-year term. Members and expiration dates (at December 31) of their current terms are:

Donald J. Kirk, Chairman	1986
Robert T. Sprouse, Vice Chairman	1985
Frank E. Block	1985
Victor H. Brown	1987
John W. March	1984
David Mosso	1987
Ralph E. Walters	1983

Members are required to sever all connections with firms or institutions they served prior to joining the Board. Mr. Kirk formerly was a partner, Price Waterhouse & Co.; Mr. Sprouse, professor of accounting, Graduate School of Business, Stanford University; Mr. Block, vice president, Bache Halsey Stuart Shields Inc.; Mr. Brown, executive vice president, chief financial officer, and director, The Firestone Tire & Rubber Company; Mr. March, senior partner, Arthur Andersen & Co.; Mr. Mosso, Fiscal Assistant Secretary, U.S. Treasury Department; and Mr. Walters, director of professional standards, Touche Ross International.

The role of the director of research and technical activities has been held by James J. Leisenring since October 1, 1982 and is considered equal in importance to that of members of the Board. The director is assisted by a staff of 45 professionals drawn from public accounting, industry, academe, and government. The staff works directly with the Board and task forces, conducts research, participates in public hearings, analyzes oral and written comments received from the public, and prepares recommendations and drafts of documents for consideration by the Board.

Due Process

The Standards Board issues Statements of Financial Accounting Standards, Statements of Concepts, and Interpretations. Statements of Financial Accounting Standards establish new standards or amend those previously issued. Statements of Concepts provide a guide to the Board in solving problems and enable those who use financial reports to better understand the context in which financial accounting standards are formulated. Statements of Concepts do not establish new standards or require any change in existing accounting principles. Interpretations clarify, explain, or elaborate on existing standards. The FASB staff issues Technical Bulletins to provide guidance on applying existing standards to certain financial accounting and reporting problems on a timely basis.

Before it issues a Statement, the Board is required by its rules to follow extensive "due process" procedures which in many ways are more stringent than the requirements of the Federal Administrative Procedure Act.

In connection with each of its major projects, the Board takes the following steps:

- Appoints a task force of technical experts representing a broad spectrum of preparers, auditors, and users of financial information to advise on the project
- Studies existing literature on the subject and conducts such additional research as may be necessary
- Publishes a comprehensive discussion of issues and possible solutions as the basis for public comment
- Conducts a public hearing
- Gives broad distribution to an exposure draft of the proposed Statement for public comment

The Board's deliberations are open to the public, and a complete public record is maintained.

Issues Resolved or under Consideration

Among the significant and long-standing issues of financial accounting and reporting that have been resolved by the FASB are: accounting for research and development costs; self-insured losses; catastrophe losses incurred by property and casualty insurance companies; losses from expropriations of property by foreign governments; reporting by development stage companies; accounting for leases; segment reporting; capitalization of interest cost; accounting for defined benefit pension plans; foreign currency translation; and the effects of rate regulation on accounting for regulated enterprises. Other important projects on the Board's agenda include: accounting by employers for pensions and other postretirement benefits; accounting for income taxes; and accounting for the reporting entity, including consolidations, the equity method, and related matters.

The philosophical basis of the Board's conclusions on specific accounting issues is the conviction that reported earnings should highlight differences in risk, not obscure them, and that similar situations should be accounted for in similar ways. While that philosophy has emerged case by case, the Board has perceived from its beginning the need to develop a consistent conceptual framework for financial accounting and reporting. One of the major reasons for recurring controversy concerning the accounting process has been lack of general agreement on such basic issues as the objectives of financial reporting, definition of the elements of financial statements and criteria for recognizing them, the bases of accounting measurement (historical cost of assets vs. current cost or some other method of reflecting the effects of inflation), and how to present information about income and cash flows.

In November 1978, the FASB issued a Statement of Financial Accounting Concepts on "Objectives of Financial Reporting by Business Enterprises," and in September 1979, a Statement of Standards on "Financial Reporting and Changing Prices." In 1980, three more Statements of Concepts were issued: "Qualitative Characteristics of Accounting Information," "Elements of Financial Statements of Business Enterprises," and "Objectives of Financial Reporting by Nonbusiness Organizations." All are significant parts of the continuing effort to construct a conceptual framework for financial accounting and reporting.

An Independent Tripartite Structure

Financial Accounting Standards Board

The FASB is the operating part of a tripartite structure that is independent of all other business and professional organizations. The Board's 1983 budget is $9.3 million. Funds are obtained through contributions and sales of publications. Before the present independent standard-setting structure was created, financial accounting and reporting standards were established first by the Committee on Accounting Procedure of the American Institute of CPAs and then by the Accounting Principles Board, also an arm of the AICPA. Pronouncements of those predecessor bodies remain in force unless amended or superseded by the FASB.

Financial Accounting Foundation

The Financial Accounting Foundation, which is incorporated to operate exclusively for charitable, educational, scientific, and literary purposes within the meaning of Section 501(c)(3) of the Internal Revenue Code, is responsible for selecting the members of the FASB and its Advisory Council and for exercising general oversight (except with regard to the FASB's resolution of technical issues).

The Foundation also receives contributions and approves the FASB budget. More than half the funds contributed are from industry and the financial community, with the remainder coming from the public accounting profession and other private-sector sources.

The Foundation is separate from all other organizations. However, its Board of Trustees is made up of nominees from six sponsoring organizations whose members have special knowledge of, and interest in, financial reporting.

- American Accounting Association (academe)
- American Institute of Certified Public Accountants (public accounting)
- Financial Analysts Federation (investors and investment advisers)
- Financial Executives Institute (corporate executives)
- National Association of Accountants (primarily management accountants)
- Securities Industry Association (investment bankers and brokers)

There also is a trustee at large whose election was endorsed by the principal national associations in the banking industry. Members of the Board of Trustees are: William H. Dougherty, Jr. (president, FAF), vice chairman, Southeast Banking Corporation; Charles G. Steele (vice president, FAF), managing partner, Deloitte Haskins & Sells; Sidney Davidson, Arthur Young professor of accounting, University of Chicago Graduate School of Business; Paul J. Dunphy, senior vice president-finance, Anchor Hocking Corporation; R. Leslie Ellis, group vice president, Armstrong World Industries; Thomas L. Holton, chairman and chief executive, Peat Marwick, Mitchell & Co.; Duane R. Kullberg, chairman and chief executive, Arthur Andersen & Co.; Paul Lambert, Jr., CPA; Warren J. Robertson, Nabisco Brands, Inc.; Edus H. Warren, Jr. (secretary-treasurer, FAF), vice chairman, Capital Research Company; and Rholan E. Larson, managing partner, Larson, Allen, Weishair & Co., *ex officio*. There is one vacancy which is to be filled by a nominee of the Securities Industry Association.

Financial Accounting Standards Advisory Council

The Financial Accounting Standards Advisory Council has responsibility for consulting with the Standards Board as to major policy questions, technical issues on the Board's agenda, project priorities, matters likely to require the attention of the FASB, selection and organization of task forces, and such other matters as may be requested by its chairman or the FASB chairman. The Council has 39 members who are broadly representative of preparers, auditors, and users of financial information. Paul Kolton, former chairman of the American Stock Exchange, is Council chairman.

January 1983

FACTS about FASB

Financial Accounting Standards Board • High Ridge Park, P.O. 3821, Stamford, Connecticut 06905-0821

Patricia Pride, Government Relations Manager 1129 20th Street, N.W. Washington DC 20036 202-466-8016

Relationships with the Federal Government

The Financial Accounting Standards Board is the designated organization in the private sector for establishing standards of financial accounting and reporting. Those standards are, in effect, rules governing the preparation of financial reports. The FASB's function is important because decisions regarding allocation of capital (investment and credit) are based on financial information, much of which is the product of the financial accounting/reporting process.

The FASB succeeded the Accounting Principles Board of the American Institute of Certified Public Accountants as the standard-setting body in 1973. The FASB is independent of and separate from the AICPA and all other professional organizations. The standard-setting process is conducted under formal rules of procedure which require extensive public participation, including public hearings on major projects and issuance of proposed standards for public comment before adoption. All decision-making meetings of the Board are open to public observation.

The Board consults regularly with a Financial Accounting Standards Advisory Council of approximately 40 members who are broadly representative of all parties having an interest in financial reporting, including the federal government.

Because of the public implications of its work, the Board recognizes an obligation to maintain effective liaison with the federal government. The purpose is not to seek advantages, but to fulfill a public responsibility. Liaison is most active with, but not limited to, the Securities and Exchange Commission.

Relationship between FASB and SEC

Interaction between the FASB and government began in the Board's first year. The SEC has statutory authority under the Securities Act of 1933 and the other securities laws to develop financial accounting and reporting standards, but in its Accounting Series Release 150 (December 1973) the SEC recognized FASB pronouncements as authoritative accounting and reporting standards and announced that it would look to the FASB for leadership in establishing and improving standards. (In April 1982, ASR 150 was codified in SEC Financial Reporting Release No. 1, Section 101.)

The Standards Board and the Commission maintain a close working relationship to foster cooperation and a climate that a former SEC chief accountant described as one of "mutual nonsurprise." The Board members and the Commissioners meet together on a regular basis to discuss matters that are of concern to both bodies. The chief accountant of the SEC participates as an observer, but with the privilege of the floor, in quarterly meetings of the Financial Accounting Standards Advisory Council. Members of the chief accountant's staff are assigned to follow the development of specific FASB technical projects. They participate in meetings of advisory task forces on those projects and frequently observe meetings of the Board.

The Commission often refers financial reporting problems to the Board for solution. When appropriate, the SEC has withdrawn its own rules after the Board has acted; for example, the FASB Statement on accounting for the effects of inflation replaced the Commission's replacement cost rule.

Only once has the SEC overruled the Board. That happened in 1978 when the Commission rejected the FASB standard for reporting by oil and gas producing companies. This was a special situation in which Congress (in the Energy Policy and Conservation Act of 1975) directed the SEC to develop a reporting system for oil and gas producers and explicitly permitted the Commission to rely on the FASB for accounting and reporting standards. The FASB issued such standards in 1977, within the time frame specified in the Act. After extensive consideration, including its own public hearings and those conducted by the Department of Energy, the SEC concluded in 1978 that existing accounting practices, including the one favored by the FASB, were inadequate. The Commission set out to develop a new system of "reserve recognition accounting," but in 1981 announced that it no longer considered RRA to be a potential method of accounting in the primary financial statements and that it would support an FASB effort to develop disclosure requirements for oil and gas producers. In April 1982, the FASB asked for public comment on its proposal. The final Statement was issued in November 1982.

Relationship between FASB and GAO

The General Accounting Office is another agency with which the Board interacts frequently. The Comptroller General is a member of the Financial Accounting Standards Advisory Council, and GAO staff often provide input to Board projects and participate in task force meetings.

Other Relationships and Issues

The pattern of FASB relationships with the federal government changes constantly, reflecting the issues that are of greatest urgency at any time. Current issues that are of mutual concern to the FASB and the federal government include pensions, accounting for inflation, thrift institutions, income tax accounting, regulated enterprises, and small businesses. The Board periodically conducts briefing sessions in Washington to inform those in government about specific agenda projects or other activities.

Pensions

With enactment of the Employee Retirement Income Security Act (ERISA) came need for the government to develop reporting and disclosure regulations. At the same time, the Board began its project to set standards for financial reporting by defined benefit pension plans. The FASB and the Department of Labor worked together to develop useful disclosures that would not impose unnecessary reporting burdens on administrators of pension plans. Again, the FASB chairman participated in numerous meetings and in the Department's public hearing. Pension issues continue to hold the attention of the Board and government. Currently, the Board is developing standards for accounting for pension costs by employers, and the Congress is considering legislation dealing with pension plans. Board and staff have regular contacts with the Department of Labor, key congressional committees, and others concerned with pension policy.

Inflation Accounting

An FASB project that has stimulated interest in Washington for several years is the standard requiring large companies to report the effects of changing prices (inflation) on their business. During the development of Statement 33, which was published in 1979, the usual close liaison with the SEC was maintained. There also were extensive discussions with the Treasury Department and the IRS to work out a change in the LIFO conformity rules which would make it feasible for companies to use the new standard without concern about the effect on taxes.

After the standard was adopted, briefings were conducted for representatives of Treasury, IRS, statistical agencies of Commerce and Labor, the SEC and other independent regulatory agencies, bank regulatory agencies, and congressional committees. The FASB chairman testified on the standard at a hearing on capital formation before the Joint Economic Committee. In addition, Board and staff meet often with interested government officials to provide current information about the results of Statement 33. The FASB is monitoring and studying the results for a five-year period with a view to making changes in the standard if a need is indicated.

Thrift Institutions

Another emerging problem that has required close liaison between the FASB and federal policymakers is the plight of the thrift institutions. Board members and staff have met often with regulators of financial institutions to explore the relationship of accounting rules to proposed solutions to the problems of thrift institutions. Recently, the Board published Statement 72, which deals with accounting for certain acquisitions of financial institutions.

Income Tax Accounting

The project on income tax accounting includes reconsideration of existing authoritative accounting pronouncements in this area. Current research efforts will aid the Board in developing a discussion document expected in mid-1983. Board and staff will maintain close liaison with tax policymakers to inform them about the Board's progress and to seek their views on issues of mutual interest.

Regulated Enterprises

The FASB considered how to account for the effects of regulation of an enterprise's prices based on its costs (for example, in the case of a public utility). Representatives of several federal and state regulatory bodies participated in the Board's efforts in this area, which led to issuance of Statement 71 in December 1982.

Small Business

The FASB recognizes that financial reporting needs of small businesses may differ from those of other companies. Currently, the Board is seeking to learn more about the information needs of users of financial statements of private and small public companies. That effort involves frequent contact with the Small Business Administration, the SEC's Office of Small Business Policy, and congressional committees.

Oversight

Ongoing review of the standard-setting process by the trustees of the Financial Accounting Foundation, who have responsibility for appointing members of the FASB, raising funds, and exercising general oversight (except with regard to resolution of technical issues), has brought improvements in the Board's structure and procedures. A major review was completed in 1982. Because the SEC has statutory responsibility for standards of financial reporting, the relevant oversight committees of the Senate and House also have reviewed the FASB's performance on occasion. The FASB continues to have frequent contacts with those oversight committees as well as others handling issues that have implications for financial accounting and reporting standards. The Board keeps such committees informed with regard to the FASB's mission and progress on specific projects. In addition, the FASB provides lawmakers and regulators with timely information on matters relating to financial reporting that might assist them in their work.

The FASB's Washington Office

The FASB headquarters are Stamford, Connecticut, approximately one hour from New York City and easily accessible to persons needing to visit the Board. To improve communication with government, the Board, in 1978, opened a small Washington office and added a Government Relations Manager, Patricia Pride, to its staff. The Washington office is able to provide FASB documents and other information to the Congress, executive departments, independent federal agencies, and other interested parties on request. The office also is prepared to arrange for the FASB to provide input to federal officials on specific subjects about which the FASB has special knowledge.

The address of the Washington office is Suite 509, 1129 20th Street, N.W., Washington, DC 20036, and the telephone number is 466-8016.

March 1983

Preliminary Views

of the Financial Accounting Standards Board

on major issues related to

Employers' Accounting for Pensions and Other Postemployment Benefits

Financial Accounting Standards Board
November 1982

Public Hearing

The preliminary views in this document result from the Board's consideration of written and oral responses to the Discussion Memorandum issued in February 1981. The Board intends to publish a second discussion document presenting additional issues. That document will announce the date of a public hearing on those additional issues and on the preliminary views in this document.

Written Comments

Written comments on the preliminary views are invited and may be submitted separately or combined with comments on the issues in the second discussion document. The deadline for comments on both documents will be announced at the time the second discussion document is issued. One copy of written comments (preferably on 8 1/2 x 11 white paper) should be addressed to the Director of Research and Technical Activities at the address listed below.

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File Reference No. 1032
Financial Accounting Standards Board
High Ridge Park
Stamford, Connecticut 06905

SUMMARY

The FASB has considered the issues addressed in the February 1981 Discussion Memorandum, *Employers' Accounting for Pensions and Other Postemployment Benefits*, and has decided to publish its preliminary views on those issues for comment. The preliminary views are a step toward an Exposure Draft of a Statement of Financial Accounting Standards, but they are not themselves an Exposure Draft. The Board is also conducting a field test of the preliminary views with a number of employers to help it assess the potential impact and identify implementation problems. Before issuing an Exposure Draft, the Board intends to solicit comments from the public on the preliminary views and on additional issues that are part of the second phase of this project. Comments will be sought in writing and at a public hearing. Only after comments are considered by the Board and the additional issues are deliberated will an Exposure Draft be considered. The Board will also seek and consider comments on the Exposure Draft before proceeding to a final Statement.

Employers' Accounting for Pensions

The proposal for pension accounting described in this document would apply to a noncontributory **defined benefit pension plan**[*] sponsored by a single employer in the United States that is not **funded** using contracts with insurance companies. Other types of plans (for example, defined contribution plans and **multiemployer plans**) will be considered as part of the project's second phase.

Liabilities and Assets

The proposal involves recognition in the employer's statement of financial position of pension-related liabilities and assets that are not recognized under current generally accepted accounting principles. Information about pension liabilities and assets is currently shown primarily in footnotes to financial statements.

Under the proposed accounting (and subject to changes that may result as the Board's consideration of the issues in this project proceeds), a typical employer would include two pension-related items in its statement of financial position. The first of these, the *net pension liability (or asset)*, represents the employer's obligation to provide pension benefits to employees in exchange for **services** already rendered by the employees to the extent that the benefits are not already provided for (funded) by assets held by the pension plan. Some companies have plan assets greater than their benefit obligations and, as a result, would report a net asset (prepaid pensions). The *net pension liability* (or *asset*) is made up of three components which would be disclosed in the footnotes. The components are (1) the **pension benefit obligation,** (2) the *plan assets*, and (3) a **measurement valuation allowance.** The third component reduces the measurement volatility of the **net pension liability** (or asset) that is inherent in the predictions of future events that must be made and is described in more detail under "Measurement" below.

The second new item to be included in the statement of financial position is an *intangible asset* representing expected economic benefits to be realized by the employer as a result of past plan amendments or the initiation of the plan. When a plan is amended or initiated and credit is given retroactively for employee services already rendered, the result is an increase in the *pension benefit obligation* and in the *net pension liability*. Presumably, an increased pension benefit obligation is incurred with the expectation that the employer will realize economic benefits in future periods; in other words, the amendment or initiation is expected to benefit the operations of future periods. Those future economic benefits underlie the intangible asset which will be amortized by charges to periodic pension cost in future periods. Under the proposal, a plan amendment or initiation would not immediately change the amount of shareholders' equity.

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[*] Words appearing in the glossary (Appendix A) are set in **boldface type** the first time they appear.

Figure 1 illustrates the elements of the statement of financial position described above.

Figure 1

STATEMENT OF FINANCIAL POSITION

Assets		Liabilities	
Cash	$ X	Accounts and Notes Payable	$ X
Receivables	X	**Net Pension Liability (See Note)**	NL
Inventories	X	Long-Term Debt	X
Deferred Pension Plan Amendment and Initiation Cost	IA	Deferred Taxes	X
Property, Plant, and Equipment	X	Stockholders' Equity	X
Total	$ XXX	Total	$ XXX

Note to Financial Statement:

Pension benefit obligation	$ L
Pension plan assets	− A
Measurement valuation allowance	± MVA
Net pension liability	$ NL

Measurement

One of the significant problems of pension accounting has been the variety of different acceptable methods of measuring or computing the amount of pension cost and the pension liability. All of the methods are complex and none is widely understood. The Board has proposed to specify the use of one method that, in its opinion, is most appropriate for accounting purposes. That method is based on the terms of the pension plan and the pension benefits promised by those terms. It is similar in its basic approach to the method already required in computing the **actuarial present value** of **accumulated plan benefits.** That amount is required in the annual report filed by the plan with certain governmental agencies pursuant to the Employee Retirement Income Security Act of 1974 (ERISA) and is also a required disclosure under FASB Statement No. 36, *Disclosure of Pension Information*. The proposed method, however, departs from that existing practice in one important respect. For pension plans that define benefits in terms of the employee's future salary (often called "final-pay plans" and "career-average-pay plans"), estimated future salary levels are to be considered in making the accounting measurement. That approach has been called the "projected unit credit" method.

The various pension measurement methods were originally developed as *funding* methods to provide for systematically setting aside assets for future pension benefit payments. An accounting standard does not apply to or limit funding decisions. The Board concluded that pension plan funding is essentially a financing or budgeting decision and is, therefore, quite different from the accounting problems of measuring assets, liabilities, and expenses. Of course, financial reports will continue to provide information on the amounts that are funded regardless of how those amounts are determined.

The Board believes that the use of the specified measurement method will result in information about pension costs and obligations that is relevant, reliable, and understandable, as well as more comparable than amounts currently reported. That does not mean, however, that real differences among employers will not be reflected by the accounting or that judgment will no longer be required in accounting for pensions. All of the alternative pension measurement methods considered by the Board require **actuarial assumptions,** which are estimates of future events that will ultimately influence the amounts of pension benefits to be paid. The same assumptions are not expected to be applicable to all employers and all plans for accounting purposes, although the Board will discuss the possibility of providing general guidance on assumptions as part of the second phase of the project.

The Board also believes that plan assets should be measured at fair value because of the relevance of that information.

Many of those who responded to the Discussion Memorandum were concerned that measurements of pension benefit obligations and plan assets would be volatile and would result in reported assets and liabilities that would change so much from one period to the next as to be meaningless, if not misleading. Significant changes in the net pension liability could result when actuarial assumptions are changed and when experience in a particular period is different from the expectations encompassed in the assumptions.

The Board concluded that a significant part of that volatility is the result of the nature of a measurement process that requires predictions of future events rather than real changes in the underlying obligation. Accordingly, the Board included a *measurement valuation allowance* as a third component of the net pension liability. Changes in the other two components (the pension benefit obligation and the plan assets) that reflect changes in actuarial assumptions or experience gains and losses will initially be offset by equal and opposite changes in the measurement valuation allowance. The measurement changes will then be reflected gradually in the net pension liability and in pension cost by amortizing the measurement valuation allowance. Changes that have offsetting effects will be netted before the amortization is computed.

Periodic Pension Cost

The accrual of pension cost for a period under the proposal would be the sum of changes in the net pension liability and in the intangible asset, excluding decreases in the net pension liability that result from employer contributions.

The extent to which the proposed accounting will change the financial statements of a particular employer is not easily estimated. Depending on the accounting and funding methods used at present, pension cost may be either higher or lower than what is reported or funded under present practices. The basic measurement approach specified in the proposal (the projected unit credit method) produces a lower periodic pension cost under many circumstances than the methods most commonly used at present, but the proposed amortization of the intangible asset is more rapid than the recognition of prior service cost incorporated in most present accounting and funding methods. The Board expects that its field test of the preliminary views and similar studies prepared by respondents will provide additional information about the relationships between the proposal and the various current practices.

Transition

The Board recognizes that an immediate change to the proposed accounting approach could create serious problems for some employers and that measuring or estimating the unamortized balance of an intangible asset related to past plan amendments would be difficult and costly in some cases. Accordingly, the proposal provides for an optional prospective transition that will allow an employer to recognize the effect on equity of the new approach gradually over a number of years.

Employers' Accounting for Other Postemployment Benefits

The preliminary views on other benefits apply to plans that provide postemployment health care and life insurance benefits. As part of the second phase of this project, the Board will seek further information about other types of postemployment benefit plans and the need for further accounting standards.

The Board's preliminary views would require accrual of the cost of postemployment health care and life insurance benefits over the periods in which employees render service, provided the amounts involved are material. Accrual of the cost of postemployment benefits requires reasonable estimates and a method of attributing the cost of benefits to periods of service. It is not anticipated that the Board will specify a single approach to the measurement of the accrual, but in the Board's view, the pay-as-you-go (cash basis) and terminal funding (accrue at retirement) approaches are not appropriate.

Preliminary Views

of the Financial Accounting Standards Board

on major issues related to

Employers' Accounting for Pensions and Other Postemployment Benefits

November 1982

Financial Accounting Standards Board
of the Financial Accounting Foundation
HIGH RIDGE PARK, STAMFORD, CONNECTICUT 06905

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INTRODUCTION

1. On February 19, 1981, the FASB issued a Discussion Memorandum, *Employers' Accounting for Pensions and Other Postemployment Benefits.*[1] That Discussion Memorandum analyzes basic issues related to pension accounting and reporting requirements only for single-employer, noncontributory, noninsured, defined benefit pension plans in the United States. The Board narrowed the scope of the Discussion Memorandum because it concluded that certain fundamental issues could be addressed without having to consider in one discussion document all the issues for various types of plans and situations. Due to the complexity of the pension issues and the many types of pension arrangements, a narrow scope was deemed to be a more practical approach for both the Board and respondents. The Discussion Memorandum also addresses the accounting for postemployment benefits other than pensions.

2. One hundred ninety-three letters of comment were received in response to the Discussion Memorandum and 37 presentations were made at the July 1981 public hearing. After considering the issues and the responses received, the Board has decided to expose its preliminary views on the basic pension accounting and reporting issues for comment. This document presents those views for further consideration and discussion. The Board also is conducting a field test of the preliminary views with a number of employers to help it assess their potential impact and identify implementation problems.

3. Special considerations involved in other types of pension plan situations are discussed in an Invitation to Comment, which is to be issued shortly. Those situations include:

a. Multiemployer plans
b. Foreign plans
c. Plans funded using contracts with insurance companies
d. Defined contribution plans
e. Plans that may be terminated and situations in which the employer is not a going concern
f. Plans that are curtailed (for example, when a plant is closed)

4. The issues in the Invitation to Comment are framed in the context of the Board's preliminary views on the accounting and reporting issues for a single-employer defined benefit pension plan and for certain other postemployment benefits. The Invitation to Comment also will address implementation issues, including certain measurement and transition issues, and it will seek information about the need for different accounting requirements for private and small public companies.

5. The Board encourages interested individuals and groups to provide written responses to the preliminary views and the Invitation to Comment and to participate in a public hearing on the documents to be held early in 1983. Responses will be most useful if they include the underly-

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[1] Appendix B discusses the background and reasons for this project and its relationship to the project on accounting and reporting for employee benefit plans.

ing reasons and any supporting evidence for the views expressed.

6. After it considers the responses to the preliminary views and the Invitation to Comment, the Board intends to issue an Exposure Draft of a Statement of Financial Accounting Standards that addresses all pension arrangements.

PART I—DEFINED BENEFIT PENSION PLANS

PROPOSED REQUIREMENTS

Applicability

7. The proposed requirements in this section would apply to an employer that sponsors a noncontributory defined benefit pension plan for its U.S. employees. Issues relating to multiemployer plans, foreign plans, and plans funded by contracts with insurance companies are not addressed. Situations in which the employer is not a going concern or the plan may be terminated, plant closings, and similar events are not addressed.

Liability and Asset Recognition

8. An employer that sponsors a defined benefit pension plan would recognize in its statement of financial position:

a. A net pension liability (or asset) equal to the net total of:
   (1) The pension benefit obligation (paragraphs 10-12)
   (2) The plan's **net assets available for benefits** (paragraph 13)
   (3) The measurement valuation allowance (paragraph 14)
b. An intangible asset, if applicable (paragraph 15)

Recognition of Periodic Pension Cost

9. The employer would recognize as pension cost[2] for a period the sum of changes in the net pension liability and the intangible asset, excluding decreases in the net pension liability that result from employer contributions. That amount is also the sum of the following changes in the net pension liability and the intangible asset:

a. The increase in the pension benefit obligation attributabie to employee services during the period
b. The increase in the pension benefit obligation attributable to the accrual of interest on the obligation (This increase results from the fact that the obligation is the discounted **present value** of estimated future payments.)
c. The increase in plan assets resulting from earnings on the assets at the assumed rate, which reduces the periodic pension cost (If actual returns, including value changes, are greater or less than assumed, the difference is an experience gain or loss which would be included in the measurement valuation allowance.)
d. Amortization of the intangible asset
e. Amortization of the measurement valuation allowance, which may either increase or decrease the periodic pension cost

Liability Measurement

10. The pension benefit obligation would be measured as the actuarial present value of benefits attributed to employee service to the date of the financial statements. Except as provided in paragraph 11, benefits would be attributed to employee service based on the terms of

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[2] Pension cost for a period either may be pension expense of that period or may be capitalized along with other costs as part of the cost of an asset such as inventory.

the plan. To the extent that the terms of a plan do not relate benefits to individual periods of employee service, an equal amount of an employee's projected retirement benefit would be attributed to each year of the employee's service.

11. For a plan that defines pension benefits wholly or partially as a function of future compensation levels (a final-pay plan or a career-average-pay plan), the pension benefit obligation would be measured based on an estimate of such future compensation levels.[3] In all other respects, the measurement of the pension benefit obligation would be consistent with the measurement of the actuarial present value of accumulated plan benefits as specified in paragraphs 16-21 of FASB Statement No. 35, *Accounting and Reporting by Defined Benefit Pension Plans*.[4] Expected rates of inflation assumed in estimating future compensation levels should be consistent with those implicit in assumed rates of return. The measure of the pension benefit obligation proposed herein is also commonly referred to as "the actuarial present value of projected credited benefits" and "the actuarial present value of accumulated benefits with **salary progression**."

12. For a plan with a benefit formula not defined as a function of future compensation levels (a flat benefit plan), the pension benefit obligation would be measured as the actuarial present value of accumulated plan benefits as specified in paragraphs 16-21 of Statement 35.[5]

13. The plan's net assets available for benefits would be measured as set forth in paragraphs 9, 11, and 14 of Statement 35, except that net assets would not include contributions receivable from the employer. Statement 35 requires measurement of investments at fair value and operating assets at cost less accumulated depreciation or amortization.

14. The measurement valuation allowance results from certain changes in the measures of the pension benefit obligation and the plan's investment assets. *Measurement* changes affecting the pension benefit obligation are experience gains and losses and effects of changes in actuarial assumptions. The measurement change affecting the plan's investment assets is the net appreciation or depreciation in fair value (including both realized and unrealized gains and losses) to the extent that the change in fair value differs from the appreciation implicit in the assumed rate of return for the period. Measurement changes would be recognized prospectively (through amortization of the measurement valuation allowance—refer to paragraph 16) in measuring the net pension liability and periodic pension cost.

Plan Initiation and Plan Amendments

15. A pension plan initiation or amendment may be retroactive in that it increases or decreases the benefits attributed by the benefit formula included in the terms of the plan to prior years of

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[3] Measuring the obligation based on an estimate of future compensation levels entails considering indirect effects, such as increases in social security offsets, as well as the direct effect through the benefit formula.

[4] These and other referenced paragraphs of Statement 35 are reproduced in Appendix C.

[5] Refer to footnote 4.

service and, therefore, results in an increase or decrease in the pension benefit obligation. If the effect is an increase in the pension benefit obligation, the employer would also recognize an intangible asset and amortize it over future periods. If the effect of an amendment is to decrease the pension benefit obligation, the offsetting credit would first reduce any unamortized intangible pension asset, and the remaining credit, if any, would be deferred and amortized.

Amortization

16. The annual amortization of both the measurement valuation allowance and the intangible asset (or deferred credit) would be computed each year by multiplying the unamortized balance at the end of the period by a percentage. The amortization percentage would be equal to 100 divided by the average remaining service period of active plan participants. For example, if the average remaining service period is 20 years, the amortization percentage would be 5 percent (100 ÷ 20 = 5). The average remaining service period is the average of the number of years of future service expected from each active **participant** based on the actuarial assumptions (including **turnover**) used in estimating the pension benefit obligation. If the annual amortization is reduced to an immaterial amount, the balance may be eliminated by changing to a straight-line amortization over a period shorter than the average remaining service period.

Disclosure

17. The following would be disclosed in the financial statements or the related notes for each period for which a complete set of financial statements is presented:

a. A general description of the plan and the benefit formula
b. The nature and effect of significant changes in the factors affecting computation of the pension benefit obligation and pension cost for the period, and other significant unusual matters necessary for an understanding of the effect of the plan on the employer's financial position and results of operations
c. The components of the net pension liability (or asset) as follows:
    (1) The pension benefit obligation, showing separately the actuarial present value of accumulated plan benefits (based on past service and compensation) and, if applicable, the effect of considering estimated future compensation levels
    (2) The plan's net assets available for benefits (excluding contributions receivable from the employer)
    (3) The unamortized measurement valuation allowance
d. The unamortized balance of the intangible asset or the unamortized balance of any credit resulting from an amendment that decreases benefits
e. The amortization rate or percentage applied to the measurement valuation allowance and the intangible asset (or deferred credit)
f. The discount rates and, if applicable, the assumed rates of increase in compensation used in computing the pension benefit obligation

g. The amount of pension cost for the period
h. A general description of the employer's policy for funding the plan
i. The amount of employer contributions to the plan during the period

Use of Averages or Reasonable Approximations

18. The Board recognizes that literal application of the proposed standard could require a degree of detail in record keeping and computation that might be unduly burdensome. Accordingly, the use of averages or other methods of approximation is appropriate, provided the results obtained are reasonably expected to be substantially the same.

Transition

19. The proposal contemplates that employers may change from current practices to the proposed accounting described in this document using either of two transition approaches.

a. *Retroactive.* As of the date of initial application, an employer that chooses to use the retroactive transition approach would recognize the net pension liability and the unamortized intangible asset resulting from past plan amendments or from plan initiation. Reasonable estimates would be permitted in determining the initial balance of the unamortized intangible asset. The net effect of recognizing those items in place of previously recognized pension assets or liabilities, if any, would be charged or credited to equity as of the date of initial application. (Whether that charge or credit to equity should be included in net income of that year is to be decided by the Board as part of the second phase of this project.)

b. *Prospective.* An employer that chooses to use the prospective transition approach would recognize as of the date of initial application (1) the net pension liability (or asset) and (2) a transitional intangible asset (or deferred credit) equal to the net pension liability plus or minus any previously recognized pension asset or liability. Subsequently, the transitional intangible asset (or deferred credit) would be amortized using the method specified in paragraph 16.

20. Under either of the transition approaches, the measurement valuation allowance would have a zero balance as of the date of initial application. The choice of transition approach does not affect the balance of the pension benefit obligation or the plan assets. Under either of the transition approaches, restatement of as many prior periods as practicable is encouraged, but either approach may be used without restatement. The date of initial application is the beginning of the earliest period restated or, if there is no restatement, the beginning of the period in which new requirements become effective.

BASIS FOR PRELIMINARY VIEWS

21. This section discusses factors deemed significant by members of the Board in reaching the preliminary views about pension accounting described in this document, including various alterna-

tives considered and reasons for accepting some and rejecting others.

Basic View—The Exchange

22. The Board's preliminary views derive from the basic idea that a defined benefit pension plan is an exchange of the employer's promise to provide pension benefits for employee service. Focusing on the simple situation in which there is no credit for service prior to plan initiation or amendment, the Board concluded that the employees acquire the right to receive the defined benefits by rendering service to the employer and, because payment of the benefits is deferred until retirement, the pension may be described as a form of deferred compensation. The employer has an obligation for benefits that have been earned but not yet paid. The terms of the plan ordinarily provide the best evidence of how the obligation for benefits is incurred as employees render service.

The Employer's Pension Obligation

23. In the Board's view, the employer's primary obligation is to the employees with whom the exchange of future pension benefits for current service is made. The obligation to the employees is a direct result of benefits promised to them under the terms of the plan. The employer also has an obligation to the plan, but it is derived from the obligation to the employees.

24. Some respondents to the February 1981 Discussion Memorandum advocated a different view of the nature of the employer's obligation under a defined benefit pension plan. They argued that the employer's only obligation is to make contributions sufficient to support the plan. In this view, it is the plan—a separate legal entity—that has an obligation for benefits promised to employees. They conclude that the schedule or budget for making contributions determines the amount of the present obligation and that contributions scheduled for future periods are future obligations.

25. The Board concluded that viewing the obligation only in terms of budgeted contributions does not reflect the fundamental difference between the inherent promise and the resulting obligation under a defined benefit plan and the promise and obligation under a defined contribution plan. An employer that has undertaken an obligation to provide defined pension benefits based on service already rendered may view it as an obligation directly to the employees (looking through the funding arrangement) or as an obligation to make future contributions to the plan, but there is a present obligation based on the defined benefits under either view. The Board does not believe that the creation of a separate legal entity to receive and invest contributions and pay benefits changes the nature of that obligation. The question of when to fund the obligation by contributing assets to the plan is not an accounting issue. It is a financing question that is properly influenced by many factors (such as tax considerations and the availability of attractive alternative investments) that are unrelated to how the pension obligation is incurred.

26. Some respondents argued that the pension exchange is between the employer and the employee group rather than between the employer and each individual employee, and that the obligation

to the group should be defined in terms of contributions rather than in terms of the aggregate benefits promised to individual group members. The Board recognizes that it is not possible to reliably measure the benefit obligation for a single employee because the future events that affect the amount of benefits (such as longevity) cannot be reasonably estimated for a single individual. In the Board's view, however, the fact that reliable measurement is possible only for a group does not change the nature of the promise. The actuarial computation considers the expectation that some members of the group will live longer than others and the expectation that some individuals will terminate before vesting or die before receiving benefits. Those factors must be considered to measure the probable future sacrifice that will result from the promise of benefits to the employees. The Board concluded that the employer's obligation to the employee group is not different from the sum of obligations to individual employees if the latter are actuarially adjusted to reflect probability of nonpayment.

Liabilities and Expenses

27. FASB Concepts Statement No. 3, *Elements of Financial Statements of Business Enterprises* (hereafter *Elements*), defines liabilities as "probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events" (paragraph 28, footnote references omitted).

28. The Board concluded that the employer's obligation for defined pension benefits is a present obligation of the employer to transfer assets to others to the extent that the service on which the benefits are based has already been rendered. The obligation requiring a probable future sacrifice of economic benefits results from the establishment of the plan and from employee service as specified by the plan and thus results from past transactions or events. Accordingly, the Board concluded that the benefit obligation qualifies as a liability under the definition.

29. *Elements* defines expenses as "outflows or other using up of assets or incurrences of liabilities . . . during a period from delivering or producing goods, rendering services, or carrying out other activities that constitute the entity's ongoing major or central operations" (paragraph 65, footnote reference omitted). *Elements* also describes expenses as representing actual or expected cash outflows that have occurred or are expected to occur as a result of those operations.

30. The Board concluded that the amount of liability incurred based on service rendered during a period and the increase in the liability due to accrual of interest during a period qualify as an expense under the definition in *Elements* to the extent those costs are not capitalized along with other costs (for example, as cost of inventory).[6]

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[6] Refer to note 2 to paragraph 9.

Termination and Vesting

31. Some respondents to the Discussion Memorandum argued that, if there is a pension liability for any amount, it must be limited either to the amount that would have to be paid on plan termination or to the amount of vested benefits. Those arguments were based on the idea that the employer has discretion to avoid any obligations in excess of those limits. The Board concluded that, unless there is evidence to the contrary, accounting should be based on an assumption that the plan will continue in operation and the benefits defined in the plan will be provided. Under that assumption, the employer's probable future sacrifice is not limited to either the termination liability or amounts already vested. The Board also noted that the actuarial measurement of the obligation encompasses the probability that some employees will terminate and forfeit unvested benefits. Benefits that are expected to **vest** are probable future sacrifices and the liability in an ongoing plan situation is not limited to vested benefits.

Cash Flows

32. Some respondents suggested that pension cost should be determined based on the **actuarial funding method** used to determine employer contributions or on any acceptable actuarial funding method. They suggested that pension information will be most useful if it is closely related to information about cash flows that occurred during the period or could be expected to occur within a relatively short period thereafter.

33. The Board does not dispute the usefulness of information about cash flows, but notes that accrual accounting frequently differs from cash basis accounting and that information about cash flows is provided in statements of changes in financial position. The Board concluded that information about the obligation incurred based on employee service and other events during the period is also useful because it provides information about financial position and results of operations or performance. In FASB Concepts Statement No. 1, *Objectives of Financial Reporting by Business Enterprises*, the Board concluded:

> Information about enterprise earnings and its components measured by accrual accounting generally provides a better indication of enterprise performance than information about current cash receipts and payments. Accrual accounting attempts to record the financial effects on an enterprise of transactions and other events and circumstances that have cash consequences for an enterprise in the periods in which those transactions, events, and circumstances occur rather than only in the periods in which cash is received or paid by the enterprise. [Paragraph 44]

Reliability

34. Many respondents commented on the fact that any measure of the pension obligation requires estimates (assumptions) of future events including mortality, turnover, and rates of interest. Some argued that the lack of precision inherent in such estimates makes a reliable measure of the obligation impossible. The Board recognized that the precision

attainable in a measure of the pension obligation is less than that of many financial statement measures but concluded that the relevance of the information is sufficient to compensate for that lack of precision. The Board concluded that actuarial techniques are the best available means of coping with the problem of measuring an obligation, the amount of which is determined, in part, by future events, and that the reliability of those measures is adequate to provide useful information.

35. Because of the lack of precision inherent in estimates of the pension obligation, some respondents would estimate pension *cost* for a period using actuarial techniques and define the liability as the difference between accumulated cost and amounts funded. The Board rejected that argument because the same assumptions that are necessary to the proposed liability measure are also essential for estimates of periodic pension cost. The measures of pension cost and the pension liability that result from the suggested alternative are affected by imprecise estimates in the same way and to the same extent as those proposed by the Board. They are neither more precise nor more reliable.

36. FASB Concepts Statement No. 2, *Qualitative Characteristics of Accounting Information,* defines reliability as a combination of representational faithfulness and verifiability. In the Board's view, the two liability measures are equally difficult to verify, but the Board's proposed measure is a more faithful representation of a liability because it is an estimate of a present obligation to make future cash outlays as a result of past transactions and events. The alternative does not purport to be a measure of an obligation; it is a residual and, therefore, it cannot be a faithful representation of a liability.

Recognition vs. Disclosure

37. Some respondents agreed that information about the pension obligation or liability is needed but argued that the information would be just as useful if it were disclosed in the footnotes and, therefore, it is not necessary to mandate changes in the basic financial statements—changes that they believe would be costly and disruptive. The Board is aware that there are costs involved for both preparers and users whenever changes are made in accounting principles, but in the Board's view it is important that elements qualifying for recognition be recognized in the basic financial statements. Footnote disclosure is not an adequate substitute for recognition. The argument that the information is equally useful regardless of how it is presented could be applied to any financial statement element, but the usefulness and integrity of the financial statements is impaired by each such omission. That argument may be valid for some sophisticated users, but the Board does not believe it holds for all or even most.

Changes in Plan Terms

38. When a defined benefit pension plan is initiated or amended to increase benefits, credit is often given under the new plan terms for employees' service rendered prior to the date of the change. The Board concluded that the employer's obligation for pension benefits granted in a plan change and attributable under the

terms of the plan to prior service is not significantly different from the obligation arising year by year and that, as a result, the incremental obligation created by a plan change should be recognized as an increase in the pension benefit obligation.

39. A number of respondents argued that a plan initiation or amendment is invariably made with a view to benefiting the employer's operations in future periods rather than only in the period of the change. The Board agreed and concluded that the increase in the pension benefit obligation resulting from a plan change provides a measure of those expected future benefits that should be recognized as periodic pension cost over a number of future periods as the anticipated benefits to the employer are expected to be realized.

Intangible Assets

40. The Board concluded that a plan change gives rise to probable future economic benefits qualifying as an intangible asset of the employer. The probable future economic benefits in a particular case may include reduced employee turnover, improved productivity, reduced demands for increases in cash compensation, and improved prospects for attracting additional qualified employees. In addition, the fact that employees *want* pensions may mean that an improved pension plan will result in a reduction in total compensation cost in future periods. The cost of the intangible asset can be measured at the date of the plan change based on the amount of the liability incurred to acquire it. The Board recognizes that the life of the intangible asset and its realizable value at a subsequent date are difficult or impossible to estimate and that the amortization of the asset will necessarily be arbitrary. However, the Board concluded that amortization based on the average remaining service period of active plan participants as specified in paragraph 16 provides a reasonable basis for allocating the cost of a plan change to operations of the periods benefited.

41. Some respondents suggested that an intangible pension asset should be recognized but should be grouped with or netted against the pension liability. The Board rejected that approach because the asset cannot be used directly to satisfy the liability. There is no right of offset. In addition, some Board members believe that netting the intangible asset would have the same effect as not recognizing the liability arising from a plan change. The Board concluded that separate reporting of the asset and the liability would allow users to make a separate assessment of the future cash outflows associated with the liability and the future economic benefits associated with the asset.

42. Some Board members were influenced by respondents' arguments that recognition of the plan-change liability and immediate charge off of the related cost would represent an unacceptably radical change from current accounting and might have undesirable consequences. They regard recognition of the intangible asset as a practical solution to those problems even though certain other costs with some similar characteristics (notably research and development costs) are not currently recog-

nized as assets. Some Board members also noted that there is a precedent for the proposed solution in the present accounting for business combinations under the purchase method.

Past Services vs. Future Services

43. A number of respondents argued that pension benefits granted in a plan change are exchanged for employees' *future* services even when the amount of the benefit is computed based on prior service. In this view, the employer's liability for such benefits arises only as the future services are rendered. Some also argued that a plan amendment is a wholly executory contract and for that reason should not be recognized. The Board agreed that the obligation is undertaken in exchange for expected future economic benefits to the employer but did not believe that provided a basis for not recognizing an obligation arising from events of the current period. The Board noted that the timing of the expiration of the benefits acquired in an exchange does not necessarily determine whether an obligation qualifying as a liability has been incurred. For example, when a building is acquired in exchange for a mortgage payable, the recognition and measurement of the liability do not depend on how the future economic benefits embodied in the asset are realized. The same is true of capitalized leases. In neither case does the recognition of a liability depend on the realization of the probable future economic benefits that are inherent in the acquired asset.

Future Amendments

44. Other respondents suggested that plan amendments should be anticipated or estimated before they are made and that plan amendments occurring during a period should be treated as changes in estimates. The Board rejected that approach because of concerns about the ability to make reasonable estimates of future plan amendments and because the Board did not believe that a present obligation exists with regard to benefits to be promised in future amendments. Anticipation of future plan amendments is also inconsistent with the basic view that the terms of the present plan provide the best basis for measuring the present obligation.

Amendments Affecting Retirees

45. Some respondents argued that a plan amendment to increase benefits of retirees does not give rise to an intangible asset that qualifies for recognition in financial statements and that the cost of such an amendment should be recognized as an expense. Some Board members agree with that view in principle, but the Board concluded that it is reasonable to assume that a plan amendment is the result of an economic decision and that the same future economic benefits expected to result from benefit increases for active employees (paragraph 40) are expected to result when retirees' benefits are increased. The Board acknowledges that there are at least some cases in which retirees' benefit increases are part of collective bargaining agreements, which supports the conclusion that those benefits are exchanged for services of active employees. The Board agreed that it would be simpler and more practical to account for all plan amendments similarly.

Amendments That Reduce Benefits

46. The Board recognizes that situations might exist in which a plan amendment reduces benefits attributed to prior service. The Board concluded that accounting for such amendments should be consistent with accounting for benefit increases and that the accounting specified in paragraph 15 would accomplish that objective.

Liability and Cost Measurement

47. Measurement of pension liabilities and costs involves three problems. First, because the amount of pension benefits that will ultimately be paid on behalf of each employee depends on certain future events (such as how long the employee will live), it is necessary to make estimates or assumptions about the future events. Future events cannot be estimated with any confidence for a single individual, but for a large group such events can be projected with reasonable accuracy.

48. Second, it is necessary to determine how much of the pension benefit is attributable to an employee's past service and how much is attributable to future services. Only benefits attributable to past service can be a present obligation. The second problem, **attribution,** would exist even if all future events were known with certainty.

49. Finally, if the measure of the pension liability is the discounted present value of the obligation, it is necessary to select a discount rate. If a plan is funded by setting aside assets in a trust, the return on those assets effectively reduces the net cost of the plan. The estimated future return on plan assets is often viewed as a basis for selecting the discount rate.

Attribution—Cost Approaches vs. Benefit Approaches

50. The Discussion Memorandum describes and illustrates two families of attribution approaches: the **benefit approaches** and the **cost approaches.** Benefit approaches determine an amount of pension benefits attributed to service to date ("earned to date") and then calculate the actuarial present value of those benefits. Cost approaches project an estimated total benefit at retirement and then calculate the level cost that will be sufficient, together with interest expected to accumulate at the assumed rates, to provide the total benefit at retirement. (The cost allocated to each year may be level in dollar amount or level as a percentage of salary.)

51. The Board concluded that the measurement of pension liabilities and periodic pension cost should reflect the terms of the plan under which they arise. Because a defined benefit plan specifies the employer's promise in terms of how benefits are earned based on service, rather than how costs are incurred or how contributions are to be made, the benefit approaches were preferred. The benefit approaches are also more consistent with the Board's basic view of pensions and with the definition of liabilities. *Elements* defines liabilities in terms of obligations, and an employer's obligation under a defined benefit plan as of a particular date is for pension benefits promised by the terms of the plan rather than for an accumulation of level costs.

52. A number of respondents indicated a preference for the cost family of approaches, usually the approach defined in the Discussion Memorandum as *cost/compensation*. That preference was frequently based on the view that a pension is earned only over an employee's full career with the result that neither the obligation nor the cost can be measured on an annual basis other than by means of an allocation of the estimated total. In that view, although all of the approaches may be described as systematic and rational, the cost/compensation approach is preferable because it tends to produce a periodic pension cost that is a level percentage of compensation (assuming amounts recognized as periodic pension cost are also funded).

53. The Board rejected that view because it believes that the terms of the plan provide a more relevant basis for relating benefits promised to service rendered, and therefore, relying on the plan terms permits a measurement of the obligation at a point in time. The Board also believes that, while the "level percentage of compensation" pattern may be desirable for funding or for budgeting contributions, it does not necessarily reflect how the obligation or the cost is incurred.

54. All of the attribution approaches involve discounting amounts payable in future periods to reflect the time value of money, and no respondents advocated solutions that would not include such discounting. The way in which discounting is applied, however, is the fundamental difference between the cost approaches and the benefit approaches. A benefit approach attributes an amount of benefits to each period and then discounts that amount to determine cost for the period. For example, a benefit method might attribute an equal amount of the total projected benefit to each period. A cost approach attributes discounted amounts of cost directly. For example, a cost approach might attribute an equal amount of cost (discounted present value of benefits) to each period. The difference between the two approaches described as examples above lies in whether the discounting is performed *after* equal amounts are attributed to each period (benefit approach) or *before* (cost approach). If a **discount rate** of zero is used, the cost approach and the benefit approach are the same.

55. In the Board's view, the benefit approaches reflect the fact that a defined benefit plan is a promise of a defined benefit, and the present value of a 1-dollar benefit promised to a 25-year-old employee is less than the present value of the same benefit promised to a 64-year-old employee if both are payable at age 65. The cost approaches, by defining the attribution and discounting procedure to produce a level cost, attribute a larger part of the total pension benefit to the early years of service than do the benefit approaches.

56. For purposes of funding a plan, assigning relatively large amounts to early years may be considered by some to be desirable because it allows more time for earnings on contributed assets to compound and because it provides additional benefit security. That basic funding approach may be particularly useful in achieving funding objectives if the cost of plan amendments is to be funded over a

relatively long period after the amendment occurs.

A Single Approach

57. Some respondents also suggested that the Board should not require a single approach but should allow a choice among a number of acceptable alternatives. Many noted that choices among accounting methods (sometimes referred to as "flexibility") are allowed in other areas including inventory valuation and depreciation. They also suggested that a single, mandated approach would not achieve comparability because of differences in the assumptions required, or would impair comparability because it would obscure the different circumstances that call for different approaches.

58. The Board is not convinced that there are differences in circumstances among employers, other than differences in plan terms, that require different accounting measurement approaches. Differences such as expected rates of turnover and mortality would continue to be reflected in the estimated pension liability and periodic pension cost. The Board concluded that use of a single pension accounting approach for similar circumstances would improve comparability and understandability of financial reporting even if it were determined that no one approach provided a better measure than the alternatives (that is, if the choice were entirely arbitrary). The Board also concluded that the approaches specified in this document do provide a more appropriate measure of the obligation incurred. The Board was not convinced by those who made reference to other areas of accounting. The appropriateness of allowing a choice of methods for depreciation and inventory valuation is beyond the scope of this project.

59. Some respondents asserted that the cost of calculating amounts for accounting purposes on a basis different from that used for funding purposes would be high and would exceed the benefits of improved financial reporting. The Board noted, however, that a large part of the cost involved in an actuarial valuation is incurred in gathering and processing the input data and that the input data is largely the same for any computation approach. The Board concluded that the additional cost attributable to the proposed requirements is unlikely to be excessive. Quantifying the costs and especially the benefits of a proposed accounting change is always difficult and imprecise. For this project, the Board expects that the field test of the preliminary views will provide additional information that will be useful in assessing the cost to preparers of implementing the proposed requirements. The Board will reevaluate the expected costs and benefits in light of that information and other information that may be provided by respondents.

Future Compensation Levels

60. The Board also concluded that estimated future compensation levels should be considered in measuring the present obligation and periodic pension cost if the plan's benefit formula incorporates them. Accordingly, the Board decided that the **accumulated benefits approach** should be used for plans that define benefits without reference to compensation (flat-benefit plans). For plans that define

benefits in terms of future compensation levels (final-pay plans and career-average-pay plans), the Board concluded that the measurement should parallel the accumulated benefits approach, but with the estimated future compensation levels considered. For plans that provide the same percentage of pay for each year of service, that measurement approach is the same as the "benefit/years-of-service" approach described in the Discussion Memorandum.

61. Some respondents argued that, based on the definition of a liability, pension benefits dependent on future increases in compensation cannot be present obligations and that the liability measurement should, therefore, be based only on actual compensation experienced to date. They also noted that, if the plan were terminated or if the employee did not render future services, the employer's obligation would be limited to amounts based on actual compensation earned to date. Some Board members concur with that position. The Board concluded, however, that in measuring the probable future sacrifice based on the present obligation, the fact that the contract creating the obligation defines it as a function of future compensation (a future price) cannot be ignored. The present obligation resulting from an employer's promise to pay a benefit of one percent of an employee's *final* pay is not the same as the present obligation resulting from a promised benefit equal to one percent of the employee's *current* pay. Measuring the obligation in the first case requires an estimate of the future variable (final pay) on which the obligation is based under the contract. The Board also concluded that the amount that would be paid if the plan (or the employee) were terminated is not the most relevant and useful measure of the obligation for a company that has an ongoing plan.

62. Other respondents argued that it would be inconsistent to ignore expected future wage increases (especially those resulting from expected inflation) that will increase benefits already credited under the plan terms, and at the same time to discount the obligation using a rate that incorporates an inflation premium. The Board considered an *implicit* approach that would exclude the effects of future inflation from both the benefits computation and the discount rate, but concluded that an *explicit* approach incorporating estimates of both future wage increases and future interest rates would be preferable because it would be easier for financial statement users to understand and because the explicit discount rate represents returns actually available or expected in relevant markets.

63. The Board also noted that few pension plans provide benefits that are increased automatically based on either wage increases or inflation after an employee retires. If future compensation increases are incorporated *implicitly* by reducing the discount rate used to compute the present value of the benefit obligation, projected benefit increases during the postretirement period will be automatically incorporated at the same time unless a different (explicit) discount rate is used for those periods. Discounting benefits using an inflation-adjusted rate would, in effect, anticipate increases in retirees' benefits and be inconsistent with the Board's decision that future amendments should not be anticipated.

Choosing among Benefit Approaches

64. Among respondents who preferred the benefit family of approaches and agreed that future compensation levels should be considered, some preferred the approach that attributes the estimated total benefit to periods of service based on current employee compensation (the **benefit/compensation approach**) because compensation provides the best available information about the relative value of different years of an employee's service and, therefore, provides an appropriate basis for allocating benefits to those years.

65. As discussed above, the Board concluded that attribution based on the plan terms provides the most relevant measurement of the pension benefit obligation. The Board also noted that the benefit/compensation approach is not an acceptable basis under U.S. tax regulations for funding a final-pay plan. Some Board members believe that the Board should avoid requiring a basic accounting approach that is outside the range of allowed funding methods so that an employer is not precluded from choosing to fund on the same basis used to measure the accounting liability and pension cost.

Volatility

66. A number of respondents expressed concern about the volatility of a pension obligation measure and the practical effects of incorporating that volatility into financial statements. The Board does not believe that volatility per se is undesirable. If a financial measure purports to represent a phenomenon that is volatile, the measure must be volatile or it will not be representationally faithful. The Board also noted that the volatility of the unfunded obligation may be less than some expect provided the explicit assumptions used in the valuation of the obligation are consistent with the asset measurement. Paragraphs 20 and 21 of Statement 35 (refer to Appendix C) discuss actuarial assumptions used for accounting purposes, which may differ from those used for funding purposes.

67. However, in the case of pension liabilities, volatility may not be so much a faithful representation of the obligation (the phenomenon represented) as a result of an unavoidable inability to predict the results of future events that are anticipated in making period to period measurements. That is, the difference in periodic measures of the pension liability can result from changes in, and short-term variances from, estimates necessary to make those measurements, for example, rates of salary increase, length of employee service, and retirement ages.

68. Some respondents also believe that recognizing volatility that, in their view, is representationally faithful (for example, gains and losses that result from measuring investments at fair value) would, nevertheless, be inconsistent with the present accounting model. They argue that such a major departure should not be made in this project.

69. The Board considered those views and concluded that *measurement changes* (experience gains and losses and the effects of changes in actuarial assumptions) should not be recognized immediately as changes in the net pension liability or as periodic pension cost

but should be recognized *prospectively* over future periods to the extent they are not offset by subsequent changes. That is accomplished by establishing a *measurement valuation allowance* as a separately disclosed component of the net pension liability (or asset). As measurement changes occur, they are reflected immediately in the pension benefit obligation or in the plan assets with an equal offsetting change in the measurement valuation allowance. The result is no immediate change in the net pension liability (or asset) which is the algebraic sum of the pension benefit obligation, the plan assets, and the measurement valuation allowance. The changes then affect periodic pension cost through the amortization of the balance of the measurement valuation allowance.

70. The measurement valuation allowance is a practical means of reducing the volatility that would otherwise be introduced by measurement changes while at the same time explicitly disclosing the amounts of those changes. All of the actuarial funding methods currently used as a basis for accounting include some similar means of eliminating volatility although accounting does not currently require any disclosure of their effect.

71. The measurement valuation allowance is an example of a separate account that, like accumulated depreciation, is part of the accounting representation of an asset or a liability. Such accounts are not intended to represent separate assets or liabilities and are sometimes described as "valuation accounts."

Funding and Plan Assets

72. The Board decided that the pension plan's net assets available for benefits should be deducted from the pension benefit obligation in arriving at the net pension liability (or asset) to be included in the statement of financial position. The plan assets must first be used by the plan trustee to pay the pension liability, and therefore, a right (or requirement) of offset exists. Deducting the plan assets from the pension benefit obligation reflects the remaining obligation for which the sponsor's assets will be required. Some Board members also believe that showing pension plan assets with other assets on the statement of financial position, even with a descriptive caption, would inappropriately suggest that those assets might be available to the plan sponsor for other purposes or that the assets are under the control of the plan sponsor.

73. The Board also concluded that the plan investment assets should be measured at fair value. Fair value provides the most relevant information that can be provided for assessing both the plan's ability to pay benefits as they come due without further contributions from the employer and the future contributions necessary to provide for benefits already promised to employees. The same reasons led to a similar decision in Statement 35.

74. The Board recognizes that there may be practical problems in determining the fair value of certain types of assets. Notwithstanding those difficulties, the Board believes that the relevance of fair value of pension assets is so great as to override any objections to its use.

75. The Board considered the use of the

actuarial value of assets instead of fair value. A number of different methods of determining actuarial asset values are available, generally based on some kind of average of past market values or on long-range projections of market values intended to eliminate short-term market fluctuations. The Board concluded that those methods produce information that is less relevant and more difficult to understand than fair value.

76. The Board understands that measuring plan investments at fair value could introduce volatility into the financial statements as a result of short-term changes in fair values. Some respondents described that volatility as meaningless or even misleading, particularly in view of the long-run nature of the pension commitment, the fact that pension investments are often held for long periods, and the fact that realization of some losses can be avoided by holding assets to maturity. The Board also recognizes that changes in the fair value of investments are related to changes in the measurement of the pension liability because they are affected by some of the same economic factors. For example, a change in the level of interest rates would be expected to affect the liability by changing the discount rate and would also affect the fair value of at least some types of investments (such as bonds). In many cases such fluctuations in the pension benefit obligation and in the fair value of plan investments would tend to offset each other.

77. The Board concluded that the net appreciation or depreciation in fair value of plan investments (after deducting appreciation that is part of the assumed rate of return for the period) should be accounted for using the same prospective recognition approach and measurement valuation allowance applied to measurement changes in the liability.

78. The resulting net pension liability balance may be similar to that which would be produced if an actuarial asset value approach were used. In arriving at that result, the Board did not reject the relevance of fair value, but concluded that accounting based solely on fair value would be a significant departure from current generally accepted principles of accounting that would have implications beyond this project. In the Board's view, such a departure would not be appropriate as part of this project.

Amortization

79. The Board concluded that the intangible asset (described in paragraph 15) and the measurement valuation allowance (described in paragraph 14) should be amortized and that the amortization for each period should be a percentage of the unamortized end-of-period balance. The percentage is computed based on the estimated average remaining service period of the active participants.

80. Amortization of the intangible asset reflects the fact that the benefits to the employer of a retroactive plan change are unlikely to last indefinitely. It is a means of assigning the cost of a plan change to the periods that are expected to be benefited. Amortization of the measurement valuation allowance implements prospective recognition of measurement changes as described in paragraphs 69 (net pension liability) and 77 (plan assets). The

Board acknowledges that both amortizations are arbitrary but believes that the two are sufficiently similar that the same amortization method and period should be used for both in the interest of simplicity.

Period

81. The Board considered the following possible amortization periods for the intangible asset:

a. An arbitrary period specified by the Board
b. The estimated period to the next amendment
c. The period expected to benefit from the amendment as determined by management
d. The average remaining service period

82. The Board concluded that the anticipated benefit to the employer as a result of a plan change (the intangible asset) is related to the future service of the active employees affected by the change and that the average remaining service period is an appropriate choice on that basis. The Board further concluded that differences in the average remaining service between employers are differences in circumstances that justify different accounting results. The Board noted that APB Opinion No. 8, *Accounting for the Cost of Pension Plans,* makes reference to accounting for pension cost associated with a plan's amendment or adoption "over the remaining service lives of those in the employ of the company at the time of the plan's adoption or amendment. . ." (paragraph 12). Opinion 8 indicates that some members of the Accounting Principles Board favored that approach (paragraph 17).

83. The Board believes that the difficulty of measuring or estimating the time to the next amendment and the subjectivity of management's estimate of the period benefited by a change make those alternatives less desirable.

84. For amortization of the measurement valuation allowance, the Board also considered using a period based on the average length of economic cycles because the most significant actuarial assumptions and the fair value of assets are affected by economic conditions. However, some Board members believe that it would be difficult to assess the length of economic cycles and that the result would not be sufficiently different to justify the effort. The Board concluded that the choice of an amortization period different from that used for the intangible asset would not significantly increase the usefulness of the reported information and that a period based on the average remaining service period is reasonable and relatively objective.

Method

85. The Board considered three basic methods of amortization: the straight-line method, the interest method, and the percentage method described in paragraph 16. The straight-line method would amortize each annual addition to the account separately as a level dollar amount. It is familiar to most accountants because it is widely used for certain amortizations in current practice. The interest method includes consideration of interest accrued on the obligation. It would amortize the intangible asset, for example, so

that the sum of (a) the reduction in the asset balance and (b) interest on an amount of liability equal to the unamortized asset balance would be a level amount. The resulting amortization is similar to that of the principal of a level-payment mortgage. Reductions of the asset balance (principal) are small in the early years and rise in later years as the interest portion of the level sum (payment) declines. The interest method is commonly used as part of actuarial funding methods and is, as a result, part of current practice for accounting for pensions. Appendix D illustrates the three amortization methods.

86. When an intangible asset (expected benefits to the employer) is recognized as a result of a plan change, the Board believes it would be appropriate, in concept, to amortize the cost of each individual's added benefits over that individual's remaining period of service. In practice, the Board does not believe that the cost of making such a computation on an individual basis is likely to be justifiable. The Board viewed the percentage method as a closer approximation of the results of an individual computation than the straight-line method. The individual computation, like the percentage method, would result in a declining amortization charge with respect to the cost of a particular plan change because some of the employees who received benefits in the change could be expected to retire or terminate in each period. The percentage method is also consistent with the idea that the benefits realized by the employer as a result of a plan change are likely to be greatest in the years immediately after the change.

87. A variation on the percentage method would amortize the cost of each plan amendment separately using a constant or frozen percentage computed based on the average remaining service as of the date of that plan amendment. Each increment of the intangible asset might then have a different percentage. The Board concluded, however, that use of one amortization percentage based on the average remaining service at the time of computing the amortization would recognize remaining unamortized cost over an appropriate period. That approach also has the advantage of simplicity.

88. For the amortization of the measurement valuation allowance, the Board concluded that the percentage method is most consistent with the idea that measurement changes of opposite sign offset one another. That method starts with the net account balance (debit or credit) which is the net amount of all unamortized past measurement changes. The Board noted that, in certain circumstances, both the straight-line method and the interest method could increase the net balance of the allowance rather than decrease it.

89. The Board also believes that the percentage method is slightly simpler for both the intangible asset and the measurement valuation allowance and therefore less costly than the alternatives. The alternatives would require keeping records of an individual annual change until it is fully amortized.

90. Some have noted that the percentage method never fully amortizes a balance (that is, the balance never gets to zero), unless a change in method is made at some point. The Board observed that,

while it never reaches zero, the percentage method will reduce a balance to an immaterial amount. If additions to the balance occur from time to time, that characteristic of the method presents minimal problems. That should always be the case for the measurement valuation allowance. For the intangible asset and the transitional element, the Board decided to allow a change in method to avoid indefinite amortization.

91. In rejecting the interest method, the Board decided that the accrual of interest on the liability (that is, the recognition of the increase over time in the discounted present value) is a question separate from the amortization of the intangible asset or the measurement valuation allowance. Viewed separately, the increasing amortization charges over time under that method do not, in the Board's view, reflect a reasonable approximation of when benefits to the employer are realized.

Disclosure

General Considerations

92. Decisions on disclosure requirements involve evaluating and balancing considerations of relevance, reliability, and cost. Relevance and reliability are characteristics that make information decision useful and that make it beneficial to require disclosure of some information. Benefits expected to result from required disclosures must be compared with the costs. Evaluating individual disclosures in relation to those criteria is generally a matter of judgment. Cost, for example, is affected by several factors, one of which is the fact that some employers have a large number of different plans and some disclosures are more difficult than others to aggregate or summarize meaningfully. Also, the incremental cost of additional disclosures, to both preparers and users, may be greater than the benefit of one more piece of information as the total amount of disclosure increases.

93. The need for disclosure is also related to the accounting reflected in financial statements. If accounting choices are permitted, disclosures may be needed to explain the accounting methods used. Conversely, if accounting choices are limited, the need for additional disclosures may be reduced.

94. The Discussion Memorandum considers 10 broad areas of disclosure. A number of them are of the type required by previous accounting pronouncements, and others were identified by the task force as worthy of consideration. Opinions were diverse among respondents who addressed the issue of specific disclosures that should be required. Many suggestions were offered, but little information was provided as to how the disclosures would be used.

Description of the Plan(s)

95. The Discussion Memorandum asked whether the Board should require disclosure of information about plan provisions and employee groups covered. Respondents who addressed the issue generally favored that disclosure. However, some suggested that it would be difficult to describe briefly but adequately the possibly numerous and complex provisions if an employer sponsors a large number of plans.

96. The Board concluded that a brief description of the sponsor's plan and the type of benefit formula could assist users in understanding the financial statements, particularly in view of the fact that the measurement of the net pension liability (or asset) in the financial statements depends on the type of benefit formula. Information about the benefit formula would include whether the benefits are defined in terms of an employee's final or highest pay levels, career-average pay, or only length of service. The Board also noted that some already provide that information.

Significant Changes Affecting Reported Amounts and Other Unusual Matters

97. The Discussion Memorandum asked whether information about unusual or infrequent events and transactions should be disclosed. Respondents who addressed the issue generally favored that information, noting that it is currently required by FASB Statement No. 36, *Disclosure of Pension Information*.

98. The Board concluded that financial statements should disclose the nature and effect of significant changes in the factors affecting the computation of the net pension liability (or asset) and periodic pension cost, and other significant or unusual matters necessary to an understanding of the impact of the plans on the employer's financial position and results of operations. No disclosure would be required in the absence of significant changes or other significant matters. This information is expected to help financial statement users understand the effect of the entity's pension arrangements on year-to-year comparisons of financial position and results of operations. Examples of the kinds of changes and other matters to be disclosed when their effects are significant include plan amendments and initiations, changes in interest rate and other actuarial assumptions, and changes in the composition and size of the work force.

Components of the Net Pension Liability (or Asset) and the Intangible Asset

99. The Discussion Memorandum asked whether information about the pension obligation, in addition to that provided in the statement of financial position, should be required. Disclosure was favored by most respondents who addressed that question.

100. The Board concluded that disclosure of the components of the net pension liability (or asset), consisting of the pension benefit obligation, the fair value of plan assets, and the unamortized balance of the measurement valuation allowance, would provide useful information. The Board also determined that the unamortized balance of the intangible asset and the rate of amortization used should be disclosed.

101. The Board declined to require other disclosures such as the portion of the pension benefit obligation that is vested or the portion due to retirees. Although those disclosures may have some relevance, the Board concluded that they should not be required.

Interest Rate and Compensation Increase Assumptions

102. The Discussion Memorandum

requested comments on whether information about actuarial assumptions used to compute amounts for accounting purposes should be disclosed. Respondents who addressed that issue generally favored disclosure of the assumed interest rate (or rates). They noted that the interest rate is a significant assumption that materially affects the computation of the pension benefit information. Some also suggested that the interest rate disclosures required by Statement 36 have proven useful.

103. Respondents were divided, however, on whether actuarial assumptions other than the interest rate should be disclosed. Some opposed disclosing actuarial assumptions other than the interest rate on the basis that additional actuarial information would not be understood by most users. Some also suggested that for employers with numerous plans, the disclosures would be complex and difficult to aggregate or summarize.

104. In requiring disclosure of the interest rate and salary increase assumptions, the Board agreed that certain actuarial information is useful. It noted that those two disclosures have the most significant impact on the amounts in the financial statements, that they are related to each other, that they differ among employers, and that their effect on the financial reports is generally relatively easy to understand.

Pension Cost

105. Respondents to the Discussion Memorandum favored continuing the requirement to disclose the amount of periodic pension cost, generally noting that the information has been useful. The Board concurred with that view.

106. The Board also considered requiring disclosure of components of pension cost, especially the amount equivalent to interest on the obligation and the return on plan assets. Some Board members favored that requirement because they believe it is important for users to be able to separately assess and compare compensation cost and costs that relate to an employer's financial structure and financing decisions. They also believe that disclosure of components would contribute to greater understanding of the nature of pension costs. The Board declined to require disclosure of components of pension cost because it would add to the volume of disclosure and because the amounts of some of the components can be approximately computed using other information that is required.

107. Respondents were divided on the question of whether to require information about the relationship of periodic pension cost to employee compensation cost or to require disclosure of the amount of wages and salaries paid or accrued to facilitate analysis of that relationship. Supporters of that disclosure noted that pension cost expressed as a percentage of salaries would be useful in assessing trends. Opponents noted that if those disclosures were to be comparable, the Board would have to specify which groups of employees and what types of compensation (for example, bonuses, stock options, overtime, social security, fringe benefits) should be included. The Board decided against requiring that disclosure.

Funding (Contribution) Policy and Amounts Funded

108. Respondents who addressed the disclosure of the funding policy favored that information. They noted that the disclosure that has been required by Opinion 8 has been helpful in understanding differences between funding and accounting cost recognition and is not particularly costly to provide. Others noted that the information highlights changes in funding policies and is useful in predicting future cash flows. Many respondents also favored disclosure of amounts funded for the same reasons. Others suggested that there is no need to focus specifically on cash flow related to pension plans because the statement of changes in financial position should provide sufficient information.

109. The Board concurred with the reasons favoring the disclosures of funding policy and amounts funded. Board members observed, however, that the requirement to disclose amounts funded could be met, in some cases, by showing the difference between the amount of periodic pension cost and the amount funded in the statement of changes in financial position.

Disclosures Not Required

110. Other disclosures listed in the Discussion Memorandum and suggested by respondents were considered by the Board. The Board concluded that those suggested disclosures should not be required because they are less important than the disclosures discussed above and for reasons noted in the following paragraphs.

111. Estimates of future funding are mentioned in the Discussion Memorandum as a possible disclosure. Some respondents favored disclosing that information, suggesting that it is relevant to assessing near-term cash flows and would provide more timely information about changes in funding policy. That requirement was opposed by others who believed that presentation of forecasts of future funds flows should not be required for any specific activity. Opponents also suggested that the information is too costly to produce if done properly and that it implies greater certainty than exists.

112. Information about the plan's assets, liabilities, and benefit obligations was suggested as a possible disclosure. Several respondents noted that this would be meaningful information, since the employer's obligation is discharged through the plan. The Board reasoned that the proposed disclosures require essentially that information in summary form as the components of the net pension liability (or asset).

113. Information about the plan's actuary was suggested as another possible disclosure. Recommendations were to provide the name and professional qualifications of the actuary and comments of the actuary about any anticipated changes in plan costs or contribution rates. The Board concluded that such information is outside the scope of financial reporting.

114. Demographic information about the employee population was mentioned by several respondents. They suggested that a limited amount of demographic information could be provided at minimal cost and would be useful. For example,

disclosure of the number of covered employees, the number of retirees, and the average age of active employees might contribute to understanding the pension situation. Opponents suggested that those disclosures are outside the scope of financial reporting. The Board concluded that the usefulness of that information is not sufficient to justify requiring disclosure.

115. The actual return on pension investment assets is also perceived by some as useful information. They argued that disclosure of investment return could help users assess the reasonableness of the discount rate used in computing the liability and cost amounts. More importantly, the return achieved on what is often a very material amount of pension assets ultimately must have an effect on both earnings and cash flow. The Board concluded, however, that the usefulness of that disclosure is not sufficient to warrant requiring its disclosure.

Transition

116. The Board is aware that a retroactive application of the proposed pension accounting requirements would present practical problems for some employers. In particular, a retroactive determination of the balance of the pension benefit obligation as of a past date would often require a new actuarial valuation as of that date, which is likely to be costly and may be impracticable in some cases because relevant data no longer exist. Also, because the balance of the intangible asset is the result of an amortization of the cost of past plan changes, determining what the balance of that account would have been if the proposed approach had always been in effect presents similar problems. Finally, because of the materiality of pension amounts and the wide range of current practices, a retroactive transition might have adverse consequences for some employers.

117. The Board concluded that transition is essentially a practical question and that the choice of transition methods specified in paragraph 19 is appropriate in light of the practical problems described above. The Board also noted that the prospective transition method is similar to the transition allowed by paragraph 48 of Opinion 8:

> For purposes of this Opinion, any unamortized prior service cost (computed under the actuarial cost method to be used for accounting purposes in the future) on the effective date of this Opinion may be treated as though it arose from an amendment of the plan on that date rather than on the actual dates of adoption or amendment of the plan. If the pension plan is overfunded (see Paragraph 44) on the effective date of this Opinion, the amount by which it is overfunded (computed under the actuarial cost method to be used for accounting purposes in the future) should be treated as an actuarial gain realized on that date and should be accounted for as described in Paragraph 30.

ALTERNATIVE VIEWS

118. Two Board members agree that financial statement disclosure of accu-

mulated pension benefits, plan assets, and actuarial assumptions is necessary to provide useful information about the order of magnitude and trend of the cost of, and unfunded obligation for, pensions. They do not agree, however, with the proposed accounting requirements.

119. They believe that the proposal attempts to combine two incompatible objectives. First, it identifies an actuarial calculation of benefits accumulated to date based on employees' prior service as an accounting liability, offset by the fair value of plan investments. Then, in order to reduce the volatility of periodic pension cost, the proposal introduces leveling devices (a "measurement valuation allowance" and an "intangible asset") that, in themselves, do not qualify for recognition as assets or liabilities.

120. They observe that the pension obligation is an elusive, long-term moving target. The amount of ultimate outlays is unknown. Actuarial attempts at estimation necessarily employ major assumptions about events that will take place a half century or more into the future. Actuaries have developed various techniques to aid in the evaluation of future cash requirements and to develop funding schedules. Those techniques are not designed to determine an accounting liability. Information provided to the Board indicates that individual actuaries could develop estimates of the present value of projected benefits of identical plans with variances of 20 to 25 percent. This is understandable considering that the actuary must make assumptions about the following: interest rates and pay increases over several decades, turnover rates (including social and technological effects), retirement rates, disability and **mortality rates,** changes in marital status, and elections as to survivorship benefits. To cite just one example of the effects of unverifiable assumptions, a survey of 302 large companies shows that interest rate assumptions disclosed in 1981 financial statements ranged from 5.0 to 14.5 percent.[7] These Board members conclude that computed estimates of a pension benefit obligation based on so many unknowns are not sufficiently reliable to be a credible representation of a liability in the financial statements. The result is neither a present termination liability nor an indication of cash outflows for pensions on a going-concern basis.

121. These Board members believe that in addition to the practical measurement weaknesses, the liability proposed to be recognized (paragraph 8) has the following conceptual deficiencies:

a. The component of the liability that is based on future compensation levels does not have one of the essential characteristics of a liability—that it be a "result of past transactions or events." At a point in time, an enterprise no more has a liability for pensions based on future salaries than it has a liability for the future salaries themselves.
b. The "measurement valuation allowance" (paragraph 14) is a device created to accommodate the conflict between recognizing a liability affected by changes in actuarial

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[7] Buck Consultants, *Interest Rate Assumptions Used for Pension Disclosure in 1980 and 1981 Corporate Annual Reports* (New York: Buck Consultants, Inc., May 1982), p. 4.

calculations and current market valuations of plan assets, while at the same time attempting to shield equity and earnings from fluctuations by allocating the effects of changes over future employee service. This account is not an asset or liability; neither is it a "valuation account" to reduce an asset or liability to its present value or proceeds.

122. Further, in their view, the "intangible asset" (paragraph 15) is not a credible asset. The probable future benefit, which is the essence of an asset, is ephemeral and not measurable. This "asset" is no different from advertising, research, training, or a host of other costs that management incurs because it expects them to enhance future operations.

123. In its final effect, the proposed accounting does not measure the liability at the present value of a definite future cash outlay, nor is it an allocation over time of an estimated total outlay on a straight-line or percentage-of-compensation basis.

124. These Board members agree that pension cost should be recognized during the employees' active service. They would focus on improving the recognition of the cost of estimated ultimate benefits to present participants over the current and future accounting periods. For reasons stated earlier, they would not recognize an actuarial estimate of the present value of accumulated benefits as a liability. They would disclose information about the pension obligation in footnotes rather than accounting measurements.

125. They believe that considerations of comparability and understandability argue for narrowing the variety of actuarial methods. Given the constraints noted above, they believe the best approach to recognizing pension cost would be to use a cost/compensation actuarial method to allocate the cost of estimated total pension benefits based on participants' compensation. The effects of the inevitable changes in estimates, including those resulting from plan changes, would be recognized over the remaining service period of active plan participants as a level percentage of compensation. This allocation method, in their opinion, is more rational than the declining-balance amortization method. This method provides a better matching of expense and revenue and avoids the acceleration effect of the procedure required by paragraph 16. Although the cost/compensation approach is specified above, these Board members are more concerned with the recognition of pension cost as a level percentage of compensation than with the particular actuarial computation methods used to achieve that result.

126. These Board members would recognize (accrue) a liability based on that cost allocation. Since contributions to fund pension plans are not and should not necessarily be the same as the amounts established for accounting requirements, the balance sheet liability at any point in time would represent the amount of pension cost accrued to date for the plan, determined under a consistent method used by all enterprises, less the amounts already contributed. They believe this would be a more credible measurement of the liability since it would represent the cost of the plan to date, measured on a

uniform basis, to the extent that cost exceeds contributions. If contributions equal that cost, there would be no liability—a result that makes sense. Footnote disclosures of actuarial estimates of accumulated benefits, the amount of plan assets, contributions to the plan, pension cost, assumptions, and the effect on future cost allocations of plan or actuarial changes would provide users with meaningful information.

127. They believe this alternative would be consonant with three realistic objectives: (a) making a reasonable periodic cost measurement that attempts to relate the deferred compensation element of pensions to the amount of direct compensation earned, (b) reflecting a liability or an asset and an impact on net assets when funding gets behind or ahead of accruing cost, and (c) disclosing significant trends and changes in pension requirements and plan assets to aid user analyses. It also would eliminate the conceptual inconsistencies of the proposed accounting.

128. These Board members also disagree with the prospective transition approach (paragraph 19(b)). They believe it establishes a method of accounting for accounting changes that, while described in paragraph 117 as simply a practical expedient, is conceptually unsound, a potentially harmful precedent, and completely inconsistent with the standard for recognizing pension liabilities and costs in paragraphs 8 and 9. If a liability for prior service is to be reflected (as required in paragraph 10), equity must be affected; if a component of pension cost is prospective (as permitted in paragraph 19(b)) and wholly executory, then a liability for that component is not recognizable. The use of another "intangible asset" classification is an unacceptable attempt to reconcile a basic contradiction.

129. One of these two Board members has further objections to the proposal based upon practical and possible economic consequences considerations. In his view, the benefit attribution approach required by this proposal is an actuarial concept that defers recognition of cost until the years closest to retirement. The compensation element of pension cost is allocated to accounting periods in increasing increments similar to the pattern of sinking-fund depreciation. This allocation pattern is not generally used to allocate long-term contract costs and is particularly inappropriate when cash outlays will be far in the future rather than at the beginning of the benefited period. In his opinion, the proposed approach will generally result in understatement and mismatching of employment costs. To the extent that employers elect to fund based on accounting methods, this may cause reductions in pension funding levels and increase the risk to investors, employees, and others of increased funding in future years. He understands that predominant funding methods for final-pay plans in the United States use a cost/compensation approach. Using that approach for accounting would be cost efficient in those instances, since it would minimize the cost of actuarial valuations.

PART II—OTHER POSTEMPLOYMENT BENEFITS

PROPOSED ACCOUNTING

Applicability

130. The proposed accounting in this section would apply to an employer sponsoring a plan that provides benefits, other than retirement income benefits, to former employees or their beneficiaries. As noted in the Discussion Memorandum, there are a large number of different types of possible postemployment benefit plans. Evidence available to the Board indicates that the most significant plans are those that provide health care insurance and life insurance (or death benefits) to retirees, and the following proposed accounting is specifically applicable to those plans. Other types of postemployment benefits will be the subject of further study.

Liability and Cost Recognition

131. The cost of retirees' health care and life insurance benefits would be accrued during the service lives of employees who are expected to receive those benefits provided the amounts involved are material. Pay-as-you-go (cash basis) and terminal funding (accrue at retirement) methods would not be acceptable methods for recognizing such cost in accrual-basis financial statements.

ADDITIONAL ISSUES AND BOARD LEANINGS

132. The Board's proposal with respect to other postemployment benefits is incomplete in that several additional issues, including those related to transition from current accounting practices, must be addressed before an Exposure Draft of a Statement of Financial Accounting Standards can be prepared. Those issues are discussed in detail in the Invitation to Comment to be issued shortly.

133. Paragraph 130, above, notes that the applicability of the proposed accounting to postemployment benefits other than retirees' health care and life insurance benefits will be the subject of further study. A majority of Board members believe that information currently available indicates that most other types of benefits are not significantly different from retirees' health care or life insurance benefits, but the Board concluded it should seek more information before deciding whether the accounting specified should be required only for certain types of plans, for all plans with certain common characteristics, or for all plans that provide postemployment benefits.

134. The Board recognizes that certain types of postemployment benefits may have nominal or no cost to an employer. Examples might include retirees' continuing participation in programs that allow employees to purchase the employer's products at a discount. Other types of postemployment benefits may be provided primarily for public relations reasons and therefore may not represent compensation. An example might be retiree participation in an annual employee golf outing. The Board would not expect to require accrual of the cost of those types of benefits.

135. The Invitation to Comment will also raise the question of how to measure the

cost of retirees' health care and life insurance benefits and how to attribute or assign the cost to individual periods. Those measurements involve some of the same estimates of future events and the same attribution issues as pensions, but there are also significant differences. A majority of Board members believe that evidence currently available suggests it would be difficult, and perhaps inappropriate, to specify a uniform measurement approach for such benefits. Accordingly, one of the possibilities to be considered in the Invitation to Comment is that the measurement approach should be determined on a case-by-case basis by those who are familiar with the facts and circumstances affecting a particular plan.

BASIS FOR PRELIMINARY VIEWS

136. The Board's proposal is based on the view that most postemployment benefits are provided to employees in exchange for services and therefore may be described as a form of deferred compensation. That view leads to the conclusion that the cost associated with an employee's benefit is incurred and should be recognized in the years during which the employee provides services rather than during the postemployment period when payments are made. The same basic view leads to the conclusion that the employer has an obligation for promised benefits to the extent the benefits are attributable to service already rendered and to the extent that future payments are probable (because it is probable that conditions for an employee's entitlement will be met).

137. Responses to the Discussion Memorandum and information from other sources indicate that the most common current accounting practice is to recognize cost at the time that other postemployment benefits are paid to beneficiaries, except to the extent that the employer elects to provide such benefits through the pension plan or elects to otherwise fund them in advance. The Board's preliminary views would not permit that "cash basis" or "pay-as-you-go" accounting, at least for the specified types of benefits.

138. Few respondents disagreed with the basic view that postemployment benefits are a form of compensation. Most concluded that there is no conceptual basis for distinguishing between postemployment benefits to be paid in cash (pensions) and those provided in kind (other benefits). A number of respondents, however, advocated the continued use of cash-basis accounting for other postemployment benefits for several reasons:

a. The amounts involved would not be sufficiently material to justify the cost of the necessary estimates.
b. The employer's obligation under such plans is less binding and more avoidable than the obligation under a pension plan and therefore does not qualify as a liability.
c. The obligation under such plans is not reliably measurable or cannot be measured at a reasonable cost.

139. The Board recognizes that the amounts involved in other postemployment benefits may not be material for some employers and for some plans. It is not intended that a Statement resulting from this project would require recognition of immaterial amounts. Materiality,

however, can only be judged in the context of an individual employer's financial statements, and the Board found convincing evidence that certain types of other postemployment benefit plans, notably those providing health care and life insurance benefits to retirees, would be material measured on an accrual basis for some employers.

140. The Board also recognizes that the legal status of other benefit obligations differs in some respects from that of pension obligations and that employers may retain the right to terminate a plan and even to discontinue benefits to retirees already receiving them. The Board concluded, however, that it is inappropriate to assume for accounting purposes that a plan will be terminated in the absence of evidence that termination is likely to occur. The Board also agreed with the argument advanced by some respondents that an employer could not ordinarily terminate a plan to avoid the related obligations without suffering adverse consequences.

141. The measurement of the obligation and the pension cost resulting from a postemployment benefit plan is similar in many respects to the measurement of the corresponding amounts resulting from a defined benefit pension plan. In both cases, estimates of future events are required, and the result is less precise than some other measurements included in financial statements. Some respondents suggested that some of the estimates involved in measuring the cost of health care benefits would be less reliable than any required for pension plans because of the impact of possible changes in government programs such as Medicare and the effects of changes in the nature and price of medical services.

142. The inability to project future events accurately is obviously a limiting factor in any estimate of the cost of a benefit defined today to be paid in the future. But the Board believes that a reasonable estimate based on available evidence and current expectations will provide more useful information than no estimate. The Board concluded that inability to obtain a precise measure does not provide a basis for reporting that no cost or obligation has been incurred prior to the cash disbursement. The Board further concluded that reasonable estimates would provide an acceptable basis, and the best available basis, for measuring the cost incurred, at least for plans providing retirees' health care and death benefits.

143. The Board noted that the conclusion described above is consistent with that reached in FASB Interpretation No. 14, *Reasonable Estimation of the Amount of a Loss,* which is an Interpretation of FASB Statement No. 5, *Accounting for Contingencies*. That Interpretation concluded that, if it is probable that a loss has been incurred but the amount of the loss can only be estimated as a range, the amount of loss accrued should not be zero but an amount within the range of estimated probable outcomes.[8]

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[8] More specifically, paragraph 3 of Interpretation 14 states, "When some amount within the range appears at the time to be a better estimate than any other amount within the range, that amount shall be accrued. When no amount within the range is a better estimate than any other amount, however, the minimum amount in the range shall be accrued."

144. The Board also concluded that the measurements required could be made at a reasonable cost. The nature of the estimates required is such that use of averages or other methods of approximation may reduce the cost of providing the information without significantly impairing its usefulness, and the use of such methods is contemplated by the Board's proposal. The Board also noted that a large portion of the information necessary to estimate the cost of other benefits is already available because it is used in accounting for pension plans.

ALTERNATIVE VIEWS

145. While two Board members agree that postemployment health care and life insurance benefits are deferred compensation, they are not convinced that a reasonable estimate of the cost of health care plans can be made in all cases. They would make any accrual requirement subject to the probability of payment and the ability to make a reasonable estimate of the ultimate cost, which would depend upon the terms of specific arrangements.

Appendix A

GLOSSARY

Accumulated benefits approach
One of three basic benefit approaches. Under this approach, benefits earned to date are based on the plan formula and employees' history of pay, service, and other factors. The actuarial present value of the benefits is derived after the benefits are attributed to periods of service. (See also **Benefit approach**.)

Accumulated plan benefits
The amount of an individual's benefit (whether vested or nonvested) as of a specified date, determined in accordance with the terms of a pension plan and based on compensation (if applicable) and service to that date.

Actuarial assumptions
Assumptions as to the occurrence of future events affecting pension costs, such as mortality, withdrawal, disablement and retirement, changes in compensation and national pension benefits, and rates of investment earnings.

Actuarial funding method
Any of several techniques that actuaries use in determining the amounts and incidence of employer contributions to provide for pension benefits.

Actuarial present value
The value, as of a specified date, of an amount or series of amounts payable or receivable thereafter, with each amount adjusted to reflect (a) the time value of money (through discounts for interest) and (b) the probability of payment (by means of decrements for events such as death, disability, withdrawal, or retirement) between the specified date and the expected date of payment.

Attribution
The process of assigning pension benefits or cost to periods of employee service.

Benefit approach
One of the two groups of basic approaches to allocating or attributing benefits or cost of benefits to service. Approaches in this group assign a distinct unit of retirement benefit to each year of credited service. The actuarial present value of that unit of benefit is computed separately and determines the cost assigned to that year. The accumulated benefits approach, benefit/compensation approach, and benefit/years-of-service approach are benefit approaches.

Benefit/compensation approach
One of three basic benefit approaches. This approach attributes a percentage of the total estimated benefit to each period based on the percentage of estimated total career compensation earned in the period. The actuarial present value of the benefits is derived after the benefits are attributed to the periods. (See also **Benefit approach**.)

Benefit/years-of-service approach

One of three basic benefit approaches. Under this approach, an equal portion of the total estimated benefit is attributed to each year of service. The actuarial present value of the benefits is derived after the benefits are attributed to the periods. (See also **Benefit approach**.)

Career-average pay formula

A benefit formula that bases benefits on the employee's compensation over the entire period of service with the employer.

Cost approach

One of the two groups of basic approaches to allocating or attributing benefits or cost of benefits to service. Approaches in this group assign pension cost to periods so that the same amount of cost or the same percentage of compensation is allocated to each period. The cost/compensation approach and the cost/years-of-service approach are cost approaches.

Cost/compensation approach

One of the two cost approaches. The pension costs under this approach are attributed to periods so that the percentage of pension cost to compensation is the same for each period. (See also **Cost approach**.)

Cost/years-of-service approach

One of the two cost approaches. This approach attributes an equal amount of the estimated total cost of the pension benefit to each year of service. (See also **Cost approach**.)

Defined benefit pension plan

A pension plan that specifies a determinable pension benefit, usually based on factors such as age, years of service, and salary. A plan that is subject to ERISA and considered to be a defined benefit pension plan under the Act is a defined benefit pension plan for purposes of this document.

Defined contribution pension plan

A pension plan in which the employer's contributions are determined for and allocated with respect to specific individuals, usually as a percentage of compensation. The benefits are those that can be provided at retirement based on the value of the contributions allocated to the individual.

Discount rate

The interest rate used to adjust for the time value of money. In actuarial terms, sometimes adjustments for population decrements also are included in the discount rate. (See also **Actuarial present value** and **Present value**.)

Explicit approach to assumptions

An approach under which each significant assumption used in determining the benefit information reflects the best estimate of the plan's future experience solely with respect to that assumption.

Experience gain (loss)

The gain (loss) that results when the experience for a period differs from that projected by the actuary. Experience gains (losses) are distinguished from the effects of changes in the actuarial assumptions to be applied to future experience.

Final-pay plan formula

A benefit formula that bases benefits on the employee's compensation over a specified number of years near the end of the employee's service period with the employer.

Flat-benefit plan formula

A benefit formula that bases benefits on a fixed amount per year of service, such as $20 per month of retirement income for each year of credited service.

Fund

Used as a verb, to pay over to a funding agency (as, to fund future pension benefits, or to fund pension costs). Used as a noun, assets accumulated in the hands of a funding agency for the purpose of meeting retirement benefits when they become due.

Funding method

(See **Actuarial funding method**.)

Implicit approach to assumptions

An approach under which two or more assumptions do not individually represent the best estimate of the plan's future experience with respect to those assumptions. Instead, the aggregate effect of their combined use is presumed to be approximately the same as that produced by an explicit approach.

Interest

The return earned or to be earned on funds invested or to be invested to provide for future pension benefits. In calling the return *interest*, it is recognized that in addition to interest on debt securities, the earnings of the pension fund may include dividends on equity securities, rentals on real estate, and gains or (as offsets) losses on fund investments.

Measurement valuation allowance

The valuation allowance that results from prospective recognition of experience gains and losses, changes in actuarial assumptions, and the net appreciation or depreciation in the fair value of plan investment assets (including both realized and unrealized gains and losses) after giving effect to the assumed rate of return for the period. The measurement valuation allowance is a component of the net pension liability.

Mortality rate

The mortality rate, also known as the death rate, is the proportion of the number of deaths in a specified group to the number living at the beginning of the period in which the deaths occur. Actuaries use mortality tables, which show death rates for each age, in estimating the amount of future retirement benefits that will become payable.

Multiemployer plan

A pension plan that is maintained jointly by two or more unrelated employers, pursuant to one or more collective-bargaining agreements. Employers are considered to be unrelated if they are not under common control. For example, a parent and subsidiary would be treated as a single employer.

Net assets available for benefits

The difference between a plan's assets and its liabilities. For purposes of this definition, plan assets do not include contributions receivable from the employer, and plan liabilities do not include the plan's pension benefit obligation.

Net pension liability

The pension benefit obligation, less the net assets available for benefits, plus or minus the measurement valuation allowance.

Participant

Any employee or former employee, or any member or former member of a trade or other employee association, or the beneficiaries of those individuals, for whom there are accumulated plan benefits.

Pension benefit obligation

The actuarial present value of the accumulated benefits attributed to employee service to the date of the financial statements, based on the terms of the plan. The pension benefit obligation is a component of the net pension liability.

Present value

The value today of an amount or series of amounts payable or receivable in the future. Present value is determined by discounting the future amount or amounts at a predetermined rate of interest. In pension plan valuations, actuaries often combine arithmetic factors representing probability (examples include factors for mortality or withdrawal) with arithmetic factors representing discount (interest). Consequently, to actuaries, determining the present value of future pension benefits may mean applying factors of both types. (See also **Actuarial present value**.)

Retroactive benefits

Benefits provided by a plan amendment that gives credit for service prior to the date of the plan amendment.

Salary progression

Projection of salaries to be earned in future years.

Service

Employment taken into consideration under a pension plan. Years of employment before the inception of a plan constitute an employee's past service; years thereafter are classified in relation to the particular actuarial valuation being made or discussed. Years of employment (including past service) prior to the date of a particular valuation constitute prior service; years of employment following the date of the valuation constitute future service; a year of employment adjacent to the date of valuation, or in which such date falls, constitutes current service.

Single-employer plan

A pension plan that is maintained by one employer. The term *single-employer plan* also may be used to describe plans that are maintained by related parties such as a parent and subsidiary.

Turnover

Termination of employment for a reason other than death or retirement.

Vest (Vested) (Vesting)

An employee's right to receive a present or future pension benefit *vests* when that right to eventually receive the benefit is no longer contingent on remaining in the service of the employer. (Other conditions, such as inadequacy of the pension fund, may prevent the employee from receiving the vested benefit.) Under graded vesting, the initial right to receive a pension in the future may be a stated percentage of the benefit based on the number of years of accumulated credited service; thereafter, the percentage may increase with the number of years of service or of age until the right to receive the entire benefit has vested.

Appendix B

BACKGROUND

B-1. The Financial Accounting Standards Board added two projects to its agenda in 1974: accounting and reporting for employee benefit plans and accounting by employers for pensions. Those projects were added to the agenda in response to both the passage of ERISA and certain criticisms concerning perceived deficiencies in APB Opinion No. 8, *Accounting for the Cost of Pension Plans*. ERISA introduced changes in the legal status and the perceived nature of an employer's obligation for pension benefits. Critics of Opinion 8 have asserted that pension cost is not comparably measured from company to company and often not even from period to period for the same company. There has been concern expressed about significant unrecorded amounts of unfunded pension obligations. Confusion and misunderstanding have resulted from the fact that (a) the amount of unfunded pension obligations depends on how pension obligations are measured and (b) a variety of pension measurement systems are widely accepted for making such measurements.

B-2. In recent years there have also been significant changes in economic factors affecting pension plans, including the onset of high inflation and interest rates, that have contributed to concern about the nature and amount of unfunded pension obligations.

B-3. The following is a brief outline describing the steps the Board has taken on the two major employee benefit projects:

a. In December 1974, the Board issued FASB Interpretation No. 3, *Accounting for the Cost of Pension Plans Subject to the Employee Retirement Income Security Act of 1974*. That Interpretation was issued to clarify the accounting for the cost of pension plans covered by the Act, pending completion of the major project on accounting by employers for pensions.

b. Task forces for both projects were formed in early 1975.

c. An FASB Discussion Memorandum, *Accounting and Reporting for Employee Benefit Plans*, was issued in October 1975.

d. In February 1976, the Board held a public hearing on the issues covered in the October 1975 Discussion Memorandum. Twenty-three presentations were made at the hearing.

e. In 1976, the Board decided to focus first on the employee benefit plans project because of the lack of any standards in that area. By deferring action on the accounting by employers project, the Board also expected to benefit from further progress on its conceptual framework projects.

f. An FASB Exposure Draft, *Accounting and Reporting by Defined Benefit Pension Plans*, was issued in April 1977. The Board received more than 700 comment letters, which indicated the need to further consider the issues.

g. In July 1979, the Board issued a revised FASB Exposure Draft, *Accounting and Reporting by Defined Benefit Pension Plans*.

h. Also in July 1979, the Board issued an FASB Exposure Draft, *Disclosure of Pension and Other Post-Retirement Benefit Information*. It proposed amending the disclosure requirements of Opinion 8 pending the Board's comprehensive consideration of accounting and reporting by employers for pensions and similar benefits.

i. In March 1980, the Board issued FASB Statement No. 35, *Accounting and Reporting by Defined Benefit Pension Plans*, which addresses financial reporting by plans, rather than by sponsoring employers.

j. In March 1980, the FASB also published *Accounting for Pensions by Employers: A Background Paper*, which highlights the changing pension environment, present accounting practices and concerns, and areas for consideration.

k. In May 1980, the Board published FASB Statement No. 36, *Disclosure of Pension Information*. Statement 36 amends Opinion 8 and requires disclosure of certain information, based on the requirements of Statement 35. Statement 36 makes no change in the basic provisions of Opinion 8 that govern measurement of pension cost and pension liabilities. The Statement is an interim step pending completion of the major project on employers' accounting for pensions.

l. In February 1981, the Board issued an FASB Discussion Memorandum, *Employers' Accounting for Pensions and Other Postemployment Benefits*. That memorandum analyzes basic issues related to accounting and reporting requirements only for single-employer noninsured, defined benefit pension plans in the United States. One hundred ninety-three letters of comment were received in response to the Discussion Memorandum.

m. In July 1981, the Board held a public hearing on the issues covered in the February 1981 Discussion Memorandum. Thirty-seven presentations were made at the hearing.

Appendix C

EXCERPTS FROM FASB STATEMENT 35*

Net Assets Available for Benefits

9. The accrual basis of accounting[3] shall be used in preparing information regarding the net assets available for benefits. The information shall be presented in such reasonable detail as is necessary to identify the plan's resources that are available for benefits.

Investments

11. Plan investments, whether equity or debt securities, real estate, or other (excluding contracts with insurance companies) shall be presented at their fair value at the reporting date. The fair value of an investment is the amount that the plan could reasonably expect to receive for it in a current sale between a willing buyer and a willing seller, that is, other than in a forced or liquidation sale. Fair value shall be measured by the market price if there is an active market for the investment. If there is not an active market for an investment but there is such a market for similar investments, selling prices in that market may be helpful in estimating fair value. If a market price is not available, a forecast of expected cash flows may aid in estimating fair value, provided the expected cash flows are discounted at a rate commensurate with the risk involved.[5]

Operating Assets

14. Plan assets used in plan operations (for example, buildings, equipment, furniture and fixtures, and leasehold improvements) shall be presented at cost less accumulated depreciation or amortization.

Actuarial Present Value of Accumulated Plan Benefits

16. Accumulated plan benefits are those future benefit payments that are attributable under the plan's provisions to employees' **service** rendered to the benefit information date. Accumulated plan benefits comprise benefits expected to be paid to (a) retired or terminated employees or their beneficiaries, (b) beneficiaries of deceased employees, and (c) present employees or their beneficiaries.

17. To the extent possible, plan provisions shall apply in measuring accumulated plan benefits. In some plans, benefits are a specified amount for each year of service. Even if a plan does not specify a benefit for each year of service, another

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*Paragraph and footnote numbers in this appendix conform to those in the original.

[3] The accrual basis requires that purchases and sales of securities be recorded on a trade-date basis. However, if the settlement date is after the reporting date and (a) the fair value of securities purchased or sold just before the reporting date does not change significantly from the trade date to the reporting date, and (b) the purchases or sales do not significantly affect the composition of the plan's assets available for benefits, accounting on a settlement-date basis for such sales and purchases is acceptable.

[5] For an indication of factors to be considered in determining the discount rate, see paragraphs 13 and 14 of APB Opinion No. 21, *Interest on Receivables and Payables*. If significant, the fair value of an investment shall reflect the brokerage commissions and other costs normally incurred in a sale.

of its provisions (for example, a provision applicable to terminated employees or to termination of the plan—if independent of funding patterns) may indicate how to measure accumulated plan benefits. If the benefit for each year of service is not stated by or clearly determinable from the provisions of the plan, the benefit shall be considered to accumulate in proportion to (a) the ratio of the number of years of service completed to the benefit information date to the number that will have been completed when the benefit will first be fully vested, if the type of benefit is includable in **vested benefits** (for example, a supplemental early retirement benefit that is a vested benefit after a stated number of years of service), or (b) the ratio of completed years of service to projected years of service upon anticipated separation from covered employment, if the type of benefit is not includable in vested benefits (for example, a death or disability benefit that is payable only if death or disability occurs during active service).

18. In measuring accumulated plan benefits, the following shall apply:

a. Except as indicated in (b) and (c) below, accumulated plan benefits shall be based on employees' history of pay and service and other appropriate factors as of the benefit information date.[10]

b. Projected years of service shall be a factor only in determining employees' expected eligibility for particular benefits, such as:
   - i. Increased benefits that are granted provided a specified number of years of service are rendered (for example, a pension benefit that is increased from $9 per month to $10 per month for each year of service if 20 or more years of service are rendered)
   - ii. Early retirement benefits
   - iii. Death benefits
   - iv. Disability benefits.

c. Automatic benefit increases specified by the plan (for example, automatic cost-of-living increases) that are expected to occur after the benefit information date shall be recognized.

d. Benefits to be provided by means of contracts excluded from plan assets for which payments to the insurance company have been made shall be excluded.

e. Plan amendments adopted after the benefit information date shall not be recognized.

f. If it is necessary to take future compensation into account in the determination of Social Security benefits, employees' compensation as of the benefit information date shall be assumed to remain unchanged during their assumed future service. Increases in the wage base or benefit level pursuant to either the existing Social Security law or possible future amendments of the law shall not be recognized.

19. The actuarial present value of accumulated plan benefits is that amount as of the benefit information date that results from applying actuarial assump-

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[10] An example of the application of paragraphs 18(a) and 18(b) appears in Appendix E [of Statement 35].

tions to the benefit amounts determined pursuant to paragraphs 16-18, with the actuarial assumptions being used to adjust those amounts to reflect the time value of money (through discounts for interest) and the probability of payment (by means of decrements such as for death, disability, withdrawal, or retirement) between the benefit information date and the expected date of payment.

20. An assumption of an ongoing plan shall underlie the other assumptions used in determining the actuarial present value of accumulated plan benefits. Every other significant assumption used in that determination and disclosed pursuant to paragraph 27(b) [of Statement 35] shall reflect the best estimate of the plan's future experience solely with respect to that individual assumption. As to certain assumptions, the following shall apply:

a. Assumed rates of return shall reflect the expected rates of return during the periods for which payment of benefits is deferred and shall be consistent with returns realistically achievable on the types of assets held by the plan and the plan's investment policy. To the extent that assumed rates of return are based on values of existing plan assets, the values used in determining assumed rates of return shall be the values presented in the plan's financial statements pursuant to the requirements of this Statement.

b. Expected rates of inflation assumed in estimating automatic cost-of-living adjustments shall be consistent with the assumed rates of return.

c. Administrative expenses expected to be paid by the plan (not those paid by the sponsor) that are associated with providing accumulated plan benefits shall be reflected either by appropriately adjusting the assumed rates of return or by assigning those expenses to future periods and discounting them to the benefit information date. If the former method is used, the adjustment of the assumed rates of return shall be separately disclosed (paragraph 27(b) [of Statement 35]).

21. In selecting certain assumptions to be used in determining the actuarial present value of accumulated plan benefits, an acceptable alternative to that discussed in paragraph 20 is to use those assumptions that are inherent in the estimated cost at the benefit information date to obtain a contract with an insurance company to provide participants with their accumulated plan benefits. Those other assumptions that are necessary but are not inherent in that estimated cost shall be selected pursuant to the requirements in paragraph 20.

Appendix D

ILLUSTRATIONS

D-1. This appendix illustrates certain computations, entries, and other aspects of the Board's preliminary views on employers' accounting for pensions. The illustrations included are:

1. Accounting for a measurement change in the pension benefit obligation
2. Accounting for a change in the fair value of plan assets
3. Accounting for a plan amendment
4. Calculation of average remaining service
5. Amortization of an intangible asset using the percentage method
6. Amortization of a measurement valuation allowance using the percentage method
7. Alternative amortization approaches considered by the Board

Illustration 1—Accounting for a Measurement Change in the Pension Benefit Obligation

D-2. Illustration 1 assumes the following beginning balances of pension-related accounts (in thousands):

Intangible pension assets (dr)	$ (80)
Net pension liability:	
Present value of accumulated plan benefits	$ 940
Additional projected benefits from future salary increases	275
Pension benefit obligation	1,215
Plan assets (dr)	(970)
Measurement valuation allowance (dr)	(45)
Net pension liability	$ 200

D-3. The measurement change illustrated below could be either a change in actuarial assumptions (for example, a reduction of the discount rate) or an experience loss. The effect of the change is assumed to be an increase of $50,000 in the pension benefit obligation with both components of the obligation affected. The entry to recognize the change is: credit pension benefit obligation (or its components) and debit the measurement valuation allowance. Since both are parts of the net pension liability, the change does not immediately impact that total. The accounting for the change is illustrated below (in thousands):

	Beginning Balance	Measurement Change	Balance
Intangible pension assets (dr)	$ (80)	—	$ (80)
Net pension liability:			
Present value of accumulated plan benefits	$ 940	$ 32	$ 972
Additional projected benefits from future salary increases	275	18	293
Pension benefit obligation	1,215	50	1,265
Plan assets (dr)	(970)	—	(970)
Measurement valuation allowance (dr)	(45)	(50)	(95)
Net pension liability	$ 200		$ 200

Illustration 2—Accounting for a Change in the Fair Value of Plan Assets

D-4. Illustration 2 assumes the following (in thousands):

January 1, plan assets at fair value	$ 970
Contribution from employer	75
Benefits paid	(75)
Dividends and interest	45
Appreciation	50
December 31, plan assets at fair value	$1,065

D-5. The rate of return assumption is eight percent. For simplicity, all cash flows are assumed to occur at the end of the period. The expected return on the assets is .08 × $970,000 = $77,600. That expected return includes the dividends and interest of $45,000 and appreciation of $32,600. The remaining $17,400 of appreciation is an experience gain. The asset changes are summarized below (in thousands):

	January 1 Balance	Changes	December 31 Balance
Intangible pension assets (dr)	$ (80)		
Net pension liability:			
Present value of accumulated plan benefits	$ 940		
Additional projected benefits from future salary increases	275		
Pension benefit obligation	1,215		
Plan assets (dr)	(970)	$(95.0)	$(1,065.0)
Measurement valuation allowance (dr)	(45)	17.4	(27.6)
Net pension liability	$ 200		

Illustration 3—Accounting for a Plan Amendment

D-6. As noted in paragraph 15, a plan amendment that gives credit for service already rendered will result in an increase in the pension benefit obligation. That increase (credit) in the pension benefit obligation is offset by an increase (debit) in the intangible asset. Assuming an amendment that increases the pension benefit obligation by $240,000, the following table illustrates the accounting (in thousands):

	Beginning Balance	Plan Amendment	Balance
Intangible pension assets (dr)	$ (80)	$(240)	$ (320)
Net pension liability:			
Present value of accumulated plan benefits	$ 940	$ 160	$1,100
Additional projected benefits from future salary increases	275	80	355
Pension benefit obligation	1,215	240	1,455
Plan assets (dr)	(970)		(970)
Measurement valuation allowance (dr)	(45)		(45)
Net pension liability	$ 200		$ 440

Illustration 4—Calculation of Average Remaining Service

D-7. Under the preliminary views, the amortization is based on the average remaining service of active participants. Calculation of the average remaining service considers population decrements based on the actuarial assumptions and is not weighted for benefits or compensation. Average remaining service, like average life expectancy, cannot be reasonably estimated for a single individual, but can be estimated based on probabilities for a group. Thus, if there are 100 employees in a group and 5 percent of the original 100 are expected to retire or leave service (for all reasons) each year, the expected average remaining service can be computed even though we do not know which employees will leave in which year. The average remaining service is total future service (1,000 years) divided by the number of employees (100), or 10 years.

REMAINING SERVICE

Year	Expected Departures (A)	Years of Service (B)	Employee-Years (A x B)
1	5	.5	2.5
2	5	1.5	7.5
3	5	2.5	12.5
4	5	3.5	17.5
5	5	4.5	22.5
6	5	5.5	27.5
7	5	6.5	32.5
8	5	7.5	37.5
9	5	8.5	42.5
10	5	9.5	47.5
11	5	10.5	52.5
12	5	11.5	57.5
13	5	12.5	62.5
14	5	13.5	67.5
15	5	14.5	72.5
16	5	15.5	77.5
17	5	16.5	82.5
18	5	17.5	87.5
19	5	18.5	92.5
20	5	19.5	97.5
	100		1,000.0

(A) = the number of the original 100 employees expected to depart in the year shown.
(B) = the number of years of remaining service an employee will render, assuming departure in the year shown. Mid-year departure is assumed for simplicity.
(AxB) = the number of years of future service expected from the group of employees expected to depart in the year shown.

Illustration 5—Amortization of an Intangible Asset Using the Percentage Method

D-8. Illustration 5 shows the amortization of an intangible asset assuming an initial balance of $80,000 and increases due to plan amendments of $240,000 in year 1 and $300,000 in year 10. The amortization rate is 10 percent based on an average remaining service period of 10 years as calculated in the preceding illustration. The average remaining service is assumed to remain constant. (Amounts are shown in thousands.)

INTANGIBLE ASSET

Year	Beginning Balance	Plan Amendments Additions	Balance (A)	Amortization Rate (B)	Amortization Expense (C = A × B)	Ending Balance (A-C)
1	80	240	320	.10	32	288
2	288	—	288	.10	29	259
3	259	—	259	.10	26	233
4	233	—	233	.10	23	210
5	210	—	210	.10	21	189
6	189	—	189	.10	19	170
7	170	—	170	.10	17	153
8	153	—	153	.10	15	138
9	138	—	138	.10	14	124
10	124	300	424	.10	42	382
11	382	—	382	.10	38	344
12	344	—	344	.10	34	310
13	310	—	310	.10	31	279
14	279	—	279	.10	28	251
15	251	—	251	.10	25	226
16	226	—	226	.10	23	203
17	203	—	203	.10	20	183
18	183	—	183	.10	18	165
19	165	—	165	.10	17	148
20	148	—	148	.10	15	133

Illustration 6—Amortization of a Measurement Valuation Allowance Using the Percentage Method

D-9. Illustration 6 shows amortization of a measurement valuation allowance assuming the same constant average remaining service period as the preceding illustration. Additions to the account, representing assumed experience gains and losses and effects of changes in assumptions, vary in size and sign. (Amounts are shown in thousands.)

MEASUREMENT VALUATION ALLOWANCE

Year	Beginning Balance	Additions DR (CR)	Balance (A)	Amortization Rate (B)	Amortization Expense (C = A × B)	Ending Balance (A-C)
1	0	46.00	46.00	.10	4.60	41.40
2	41.40	6.00	47.40	.10	4.74	42.66
3	42.66	148.00	190.66	.10	19.07	171.59
4	171.59	102.00	273.59	.10	27.36	246.23
5	246.23	(139.00)	107.23	.10	10.72	96.51
6	96.51	(69.00)	27.51	.10	2.75	24.76
7	24.76	(150.00)	(125.24)	.10	(12.52)	(112.72)
8	(112.72)	(57.00)	(169.72)	.10	(16.97)	(152.75)
9	(152.75)	(107.00)	(259.75)	.10	(25.98)	(233.77)
10	(233.77)	70.00	(163.77)	.10	(16.38)	(147.39)
11	(147.39)	150.00	2.61	.10	.26	2.35
12	2.35	(74.00)	(71.65)	.10	(7.17)	(64.48)
13	(64.48)	295.00	230.52	.10	23.05	207.47
14	207.47	(37.00)	170.47	.10	17.05	153.42
15	153.42	80.00	233.42	.10	23.34	210.08
16	210.08	20.00	230.08	.10	23.01	207.07
17	207.07	(258.00)	(50.93)	.10	(5.09)	(45.84)
18	(45.84)	(189.00)	(234.84)	.10	(23.48)	(211.36)
19	(211.36)	(5.00)	(216.36)	.10	(21.64)	(194.72)
20	(194.72)	75.00	(119.72)	.10	(11.97)	(107.75)

Illustration 7—Alternative Amortization Approaches Considered by the Board

D-10. Paragraph 85 notes that the Board also considered the straight-line method and the interest method of amortization. The following illustrates those methods and compares them to the percentage method. A $100 initial balance and a 20-year period are assumed for the straight-line and interest methods. An eight-percent interest rate is used to compute the interest method amortization. The percentage method uses a constant 10-percent amortization rate which is sufficient to reduce the unamortized balance to 12.16 percent of the original amount at the end of the 20-year period.

ALTERNATIVE AMORTIZATION APPROACHES

	Percentage Method		Straight-Line Method		Interest Method* (Assuming 8% Interest)	
Year	Beginning Balance	Amortization	Beginning Balance	Amortization	Beginning Balance	Amortization
1	100.00	10.00	100.00	5.00	100.00	2.19
2	90.00	9.00	95.00	5.00	97.81	2.37
3	81.00	8.10	90.00	5.00	95.44	2.55
4	72.90	7.29	85.00	5.00	92.89	2.76
5	65.61	6.56	80.00	5.00	90.13	2.98
6	59.05	5.91	75.00	5.00	87.15	3.22
7	53.14	5.31	70.00	5.00	83.93	3.48
8	47.83	4.78	65.00	5.00	80.45	3.75
9	43.05	4.31	60.00	5.00	76.70	4.05
10	38.74	3.87	55.00	5.00	72.65	4.38
11	34.87	3.49	50.00	5.00	68.27	4.73
12	31.38	3.14	45.00	5.00	63.54	5.11
13	28.24	2.82	40.00	5.00	58.43	5.52
14	25.42	2.54	35.00	5.00	52.91	5.96
15	22.88	2.29	30.00	5.00	46.95	6.43
16	20.59	2.06	25.00	5.00	40.52	6.95
17	18.53	1.85	20.00	5.00	33.57	7.50
18	16.68	1.67	15.00	5.00	26.07	8.10
19	15.01	1.50	10.00	5.00	17.97	8.75
20	13.51	1.35	5.00	5.00	9.22	9.22

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*Under the interest method the sum of (a) the amortization and (b) interest on an amount of liability equal to the unamortized balance is a level amount. In this example, the level sum is $10.19 and interest implied by the computation in each year is .08 times the beginning balance shown. For example, in year 4, .08 × $92.89 = $7.43 and $7.43 + $2.76 = $10.19.

Senator NICKLES. Thank you very much, Mr. Kirk. I will certainly agree with you that your proposals caused a lot of controversy. I was snickering to myself, wondering if we should apply the same accountability to Government pensions, et cetera, and post those on our annual reports as we tell everybody what a great job we are doing here.

Mr. KIRK. I might comment that the experimental financial statements of the Federal Government do include information similar in many respects to what we are suggesting. Now, they are not widely disseminated and they are not widely understood, but those experimental financial statements do contain a similar measure of the pension liability.

That is, not for the social security plan, but for the Federal retirement plans.

Senator NICKLES. I do not know that—well, I will get off of that, I guess. [Laughter.]

I have a hard time in contrasting the amount of liability we see hanging over the private sector with how they compare with what we have done in the public sector. Then, again, I guess now that I am wearing a public sector hat, I see how we ignore what has been going on in that arena, and yet we rightly focus attention on trying to make some improvements in the private sector.

Some people have discussed possibly trying to cut your initiative off by statutory change. What do you think of such critics of your proposals?

Mr. KIRK. I try to urge them not to foster such a proposal, and I would urge you to think carefully before entertaining it seriously. There is a well-financed private sector effort under way now. We are financed through the private sector. We do have constituents, just as you do, who sometimes oppose what we suggest, but we do think that our process involves a great deal of research. It is an open process, and I think it is the best way to reach a particular conclusion on this subject.

In addition, our process is not complete. I did outline many of the things we have to do yet, and we do intend to assess the validity of many of the assertions that have been made about the effects of our particular proposal.

Senator NICKLES. How do you answer that criticism? Some would say that if you did have the financial status of pension funds included with the annual report, those companies that would be in the worst shape pension wise are also in the worst shape otherwise financially, and just making it that much more difficult for them to borrow needed funds, et cetera.

Mr. KIRK. One last comment on your earlier question. We do have a relationship with the SEC, and they are empowered and do exercise oversight on our activities, and so I do think there is adequate governmental oversight under the present arrangement.

Turning to your latter question of how do we respond to some of the assertions regarding the effects of our proposal, it is difficult to assess whether they are valid. I think the first question that needs to be focused on is whether our present proposal is a reasonable reflection of the facts.

It had been stated earlier that one group was trying to determine the true status of pension plans. A little bit later, it was mentioned that, for defined benefit pension plans, it may well be an indeterminable obligation.

What we are attempting to do is present as good a picture as we can as to what the status of plans is. I think the question is, Is our proposal a reasonable presentation of the facts? If it is, then I think it is unfair to say that the consequences are necessarily all adverse. There could well be beneficial consequences resulting from a better portrayal of what the status of pension plans is.

The fact that some people assert they will abandon their defined benefit pension plans, I think, is subject to very careful scrutiny because, as pointed out earlier, defined contribution plans often do not furnish the income security that a defined benefit pension plan may.

Beneficial effects can come about through a better understanding of what the status of plans is, and potentially it might favorably impact decisions made about funding. The level of understanding on pension plans is extremely low and needs to be improved. I do think that better information can help that educational process.

On balance, if there is a reasonable presentation made of the financial status of plans, I think the good consequences would outweigh the adverse consequences.

Senator **NICKLES**. Do you disagree with the critics that you might be the straw which would break the camel's back in a company who was on the verge, say, of bankruptcy and had pension underfunding problems too?

Mr. **KIRK**. I do not believe so. What we are proposing in no way affects directly the cash flow effects or the obligation that an employer has. It does affect the way in which it is presented and where it is presented, and that can influence some people, but I think the statements of the dire consequences are greatly exaggerated.

We also are proposing a rather gradual transition to a new measurement basis so that people can get used to a different presentation of what the obligation is under defined benefit pension plans.

So, I think we have a way of easing the transition that should help overcome some of the objections to what we are suggesting.

Senator **NICKLES**. I am thinking of a case like a Harvester or a Chrysler a couple of years ago—something where you had a company that was working aggressively trying to reorganize and refinance.

I have countered the argument with the fact that the creditors are probably well aware of that information, but I was wanting to know if——

Mr. **KIRK**. Yes; I think the creditors are on top of those particularly troubled situations. I cannot deny that what we are suggesting could change debt-equity ratios in the balance sheet of the corporation.

Much of the same information is available now in the footnotes to financial statements. We have in earlier projects been faced with similar arguments that what we are proposing will adversely affect debt-equity ratios; it will cause violation of indentures under bonds.

I do think we have been able to cope with those kinds of concerns in the past and I believe we can again here through a reasonable transition to a new standard.

Senator NICKLES. Would there have to be some type of uniformity as far as calculations of unfunded vested liabilities?

As pointed out by one of our previous guests, there can be a great disparity based on rates of return, inflation, mortality, et cetera.

Mr. KIRK. That is a very good question. We are proposing that there be a standard measurement of the cost of the pension plan that is charged to income each year. We have already suggested, and are reaffirming, that there should be a consistent way of measuring the unfunded obligation of sponsors.

We have not yet addressed whether certain assumptions should be standardized, and the one referred to earlier was the rate of return on the assets of the pension plan. The present disclosure that is one of our requirements has been criticized by some because it leaves latitude as to the interest rate used. Also, of course, there is latitude in the interest rate used for funding purposes.

We will be looking at that question at our next public hearing as to whether some of the assumptions might be standardized or narrowed. I personally am not optimistic that it makes sense to standardize a rate of return or interest rate.

There is the potential for variation in the actual earnings of pension plan investments, and the rate of return estimate is an attempt, if done properly, to reflect the best estimate of what might be earned. Now, that does require a crystal ball and that is extremely difficult.

But if you do not allow some latitude to take into account different situations, you will just end up with certain actuarial gains and losses that will have to be accounted for later.

Senator NICKLES. I wonder if you would not have a situation where you would have a firm that would be out trying to hire an actuary who would eventually tell them what they wanted to hear.

Mr. KIRK. Well, there are stories that that does exist. It is an area that requires professional judgment and professional responsibility and it is a difficult arena to perform in. But I do think that professional judgment has been the rule in the past.

If our standards can help narrow the areas of judgment in the future, we will most certainly take that into account.

Senator NICKLES. Thank you very much, Mr. Kirk. We appreciate your appearance before the committee.

Mr. KIRK. Thank you.

Senator NICKLES. Our next guest is Daniel F. McGinn, who is president of Dan McGinn & Associates, Anaheim, Calif.

Mr. McGinn, welcome to the committee. Please proceed.

STATEMENT OF DANIEL F. McGINN, PRESIDENT, DAN McGINN & ASSOCIATES, ANAHEIM, CALIF.

Mr. McGINN. Thank you, Mr. Chairman. My name is Dan McGinn. I appreciate having the chance to express my views on the current status and future prospects of defined benefit pension plans.

My name is Dan McGinn. I am the chief actuary of my own firm, a consulting firm which deals with corporate pension plans, multiemployer trust funds, and works with public agencies.

My professional experience spans more than 30 years of insurance and consulting work, and during the last 23 years I have been dedicated primarily to the design, administration, and funding of pension programs.

Today, my firm serves 17 multiemployer trust funds, including the two largest trust funds in the country. I have authored four books on pensions and pension funding, and three of those are dedicated to multiemployer pension plans.

In this very brief statement, I would like to limit my comments to the impact of the Multiemployer Pension Plan Amendments Act of 1980. This law, because of the employer withdrawal liability provisions, in my opinion, is inexorably leading to the decline of employer contributions to these plans.

This decline is occurring in industries where stability or growth is otherwise possible, because contributing employers are resisting making contribution increases and new employers are refusing to join these plans. This is the only way these employers have to stop the growth of their share of the unfunded liabilities or to avoid potential withdrawal liabilities.

In my opinion, this very fundamental fact will not only stop the growth of multiemployer pension plans; it will contribute to the shrinkage of the contribution base for these plans, and consequently undermine the very validity of all actuarial projections of financial soundness.

It is important to realize that employers of these plans do leave these plans for various reasons. For example, some employers go bankrupt; some employers move to a different geographical area; some simply shut down their operations, and sometimes some employers are caught up in an obsolete industry.

The withdrawal liabilities of this law have truly discouraged the entry of new employer groups to replace those who leave. From an actuarial viewpoint, it is threatening the long-term funding of these programs and the ultimate soundness of multiemployer plans.

At this very same time, we are observing defined contribution plans springing up all over the multiemployer field. These plans are capturing the contributions that otherwise would have gone to defined benefit plans. And although defined contribution plans, often referred to as IRA's or IRA-type plans, can help a younger employee and provide substantial benefits to him, it takes a long time before he will receive benefits. In the meantime, those funds are invested solely for his particular benefit.

But they have very significant limitations from the point of view of the private pension system. In particular, older workers have little time under these programs to earn and receive any significant benefits, and existing pensioners will receive nothing.

The contributions made to these defined contribution plans could have strengthened the funding status of defined benefit plans, thus allowing a more adequate pension to older employees in the old, traditional sense, and also perhaps providing some benefit adjustments to people who are already retired.

The Multiemployer Pension Plan Amendments Act in section 3 states that one of its purposes is to improve retirement income security and to relieve certain problems which tend to discourage the maintenance and growth of multiemployer pension plans.

However, the effects of this law have had the exact opposite impact. It has not been consistent, in our opinion, with the stated intentions of Congress. Something really should be done.

Considering the overwhelmingly negative environment in which contributing employers have been placed by this law, the immediate and total elimination of employer withdrawal liability does not seem feasible.

However, it seems to me that reasonable individuals who are dedicated to finding correct or just solutions to serious problems can achieve some type of reasonable compromise, and I have listed from my view four basic principles which I think, if the legislators would keep them in mind, would be helpful in trying to find a reasonable solution.

One is that both current and future participants in a defined benefit plan will achieve a significantly more adequate retirement income from a plan that continues than from a plan that terminates or fails, even if upon termination the vested benefits of the failed plan are protected.

If multiemployer plans are going to survive, they must be an acceptable bargaining alternative to both employers and the unions, while at the same time protecting the plan participants.

Another is that the legal and financial implications of employers who join these plans must be understood in advance and relied upon in advance to stop or preclude the fear of joining these plans—a plan which, under current circumstances, would impose and has imposed on employers unexpected responsibilities and financial obligations over which they sometimes have had no direct control.

If multiemployer plans are to survive and compete effectively with other retirement arrangements, and that is what had been happening for some 20 years, the trend to ever-increasing Federal regulation must be stopped.

I urge serious and intense effort to develop a solution based on some kind of a reasonable balance between the concerns of both the plan participants and the contributing employers.

[The prepared statement of Mr. McGinn follows:]

Statement of Daniel F. McGinn
on the
Current Status and Future Prospects of Defined Benefit Pension Plans

U.S. Senate Labor Subcommittee, Washington, D.C.
March 21, 1983

Mr. Chairman, I appreciate having been invited to express my views on the current status and future prospects of defined benefit pension plans.

My name is Daniel F. McGinn and and I am President and chief actuary of Dan McGinn & Associates, Inc., a consulting firm which provides technical and advisory services to corporations, multiemployer trust funds and public agencies. My experience spans more than 30 years of insurance and consulting work, and during the last 23 years, I have been primarily engaged in the design, administration and funding of pension programs. My firm currently is the consulting actuary to seventeen multiemployer trust funds, including the two largest plans in the country.

I am a Charter Member of the American Academy of Actuaries, a Fellow of the Society of Actuaries, a Fellow and Director of the Conference of Actuaries in Public Practice, a Director of the Actuarial Education and Research Fund and Chairman of the Actuaries Committee of the International Foundation of Employee Benefit Plans. I have authored four books on pension plans and their funding, and three of these texts are dedicated to multiemployer plans.

Statement

In this brief prepared statement I will limit my comments to the impact of the Multiemployer Pension Plan Amendments Act of 1980 (MPPAA), on "defined benefit" plans. I believe that the MPPAA has set the stage in many industries for the eventual destruction of multiemployer plans as we know them today. My views reflect my judgment after many years of actuarial service in the environment of collectively bargained plans. I cannot provide a statistical basis to support my view, but it is my firm opinion that this law, unless changed, will lead inevitably to the demise of this very important part of the private pension system.

Just over ten years ago, during the hearings of the House of Representatives General Subcommittee on Labor, I testified in favor of H.R. 2 which, if enacted, would have established, for pension plans, minimum disclosure requirements, fiduciary responsibilities, and minimum participation, vesting and funding standards. I also testified against the passage of H.R. 462 whose principal provisions were designed to establish a system of plan termination insurance. (The provisions of both of these bills were generally incorporated into ERISA.) It was my view then that society needed the standards incorporated in H.R. 2. It was also my view then that plan termination insurance would be unworkable. I remain convinced that adequate funding and vesting standards, rather than a plan termination insurance program, provide the best means of ensuring that participants will receive their promised benefits.

Why MPPAA Fosters a Decline in Defined Benefit Multiemployer Pension Plans

This law, because of its employer withdrawal liability provisions, is inexorably leading to the decline of employer contributions to these plans. The decline is occurring because, in industries where stability or growth is otherwise possible, contributing employers are resisting contribution increases and new employers are refusing to join these plans. Only in this way can employers reduce or avoid potential withdrawal liabilities. This circumstance will not only stop the growth of multiemployer plans -- it will cause the shrinkage of their contribution bases and consequently undermine the validity of actuarial projections of financal soundness. After all, employers do leave these plans, for example, because of bankruptcy, relocation to different geographical areas, simple termination of operation, and obsolescense of industries. The withdrawal liability provisions of MPPAA have discouraged entry of new employers to replace those who leave and thus are threatening the long term funding soundness of multiemployer plans.

Some plans are attempting to cope with the problems of employer withdrawal liability by basic plan redesign; i.e., granting benefit increases only for service rendered after a negotiated contribution increase. Although this can eventually eliminate withdrawal liability, it also severely limits benefit improvements for older employees who have inadequate pensions but little remaining service before retirement. Any approach to plan redesign may preclude measurable help to pensioners with low benefits because any benefit increase generates a vested benefit liability. In one instance the trustees of a plan without an unfunded vested benefit liability were stalemated for more than a year as regards benefit improvements. Improvements were made only after an agreement was reached to mandate future benefit reductions if a rigorous funding schedule was not maintained.

At the same time, we are observing "defined contribution" plans springing up all over the multiemployer field. These plans are capturing the contributions that otherwise would have gone to defined benefit plans. Although defined contribution plans can help younger employees a great deal, since funds will be invested many years before benefits must be paid, they have several significant limitations. In particular, older workers receive little value, and pensioners get nothing. The contributions made to these "defined contribution" plans could have strengthened the funding status of "defined benefit" plans, thus allowing a more adequate pension to older employees and to persons who are already retired.

What should be done?

The MPPAA states, in Section 3, that one of its purposes is to improve retirement income security and, further, to alleviate certain problems which tend to discourage the maintenance and growth of multiemployer pension plans. However, the effects of this law are inconsistent with the stated intentions of Congress, and now something needs to be done. Considering the overwhelmingly negative environment in which contributing employers have been placed by MPPAA, the immediate and total elimination of employer withdrawal liabilities may not be practical. After all, many employers might be tempted to withdraw as soon as practicable in fear that the government might again reverse its position. Also, different industries have different characteristics and problems, and withdrawal liability is a greater problem in some industries than in others. Finally, as long as there is a benefit guarantee program, withdrawal liability may be necessary in limited circumstances in order to protect the Pension Benefit Guaranty Corporation. However, reasonable individuals who are dedicated to finding just solutions to serious problems can achieve a reasonable compromise.

Some of the principles which should be kept in mind in any legislative considerations relating to multiemployer plans are

- both current and future participants achieve significantly more adequate retirement income from a plan which continues than from a plan which fails, even if, upon termination, vested benefits under the failed plan are protected;

- if multiemployer plans are going to survive, they must be an acceptable bargaining alternative to both employers and unions, while protecting the participants;
- the legal and financial obligations of employers must be understandable in advance to preclude the fear of joining a plan which might impose on employers unexpected responsibilities over which they sometimes have no direct control; and
- if multiemployer plans are to survive and compete effectively with other retirement arrangements, the trend to ever-increasing federal regulation of these plans must be stopped.

I urge serious and intense effort to develop a solution based on a reasonable balance of the concerns of both plan participants and contributing employers.

Senator NICKLES. Mr. McGinn, thank you for your comments. Am I correct in saying you are the chief actuary for the Teamsters Central States Fund and Western Fund?

Mr. McGINN. Yes, I am.

Senator NICKLES. Those are the two largest multiemployer funds in the country?

Mr. McGINN. Yes.

Senator NICKLES. In addition, you are also chief actuary for several other multiemployer plans?

Mr. McGINN. Fifteen other multiemployer trust funds; yes.

Senator NICKLES. Are those all related to trucking, or are they unique in other fields?

Mr. McGINN. No. The plans that we serve cover glassworkers, all the way to fish cannery workers, to sheet metal workers, to electrical workers.

Senator NICKLES. They are not all Teamster related?

Mr. McGINN. No; not at all.

Senator NICKLES. Were you aware when the multiemployer amendments were going through in 1980?

Mr. McGINN. Yes; we were very much aware of what was being considered.

Senator NICKLES. Were you supportive of the amendments at that time, or did it go around you and all of a sudden you started seeing these withdrawal liabilities?

Mr. McGINN. In 1979, to all of our clients and friends we published sort of a position paper—this was before the law was passed—outlining what we saw would happen to the multiemployer field if this law were passed.

Senator NICKLES. In opposition to it?

Mr. McGINN. Excuse me?

Senator NICKLES. Where were you coming down?

Mr. McGINN. Well, it was our view that the imposition of employer withdrawal liabilities would stop or reduce employer contributions to these plans. It would precipitate lawsuits.

Well, anyway, our position at that time has not changed. The facts, I think, are exactly as we foresaw them at that time. I would like to also comment that more than 10 years ago, before a House labor subcommittee when they were considering H.R. 2, which covered vesting, disclosure, fiduciary responsibilities, funding, participation, and so forth, we felt that all of those requirements were very good for the private pension system.

But there was also another bill that we testified on, and it was called H.R. 462. That was legislation that would impose plan termination insurance. We then, as we do now, felt that any system of plan termination insurance was unworkable and should never come into existence.

Senator NICKLES. Are you familiar with the bill that Senator Hatch authored last year which would kind of directly impact multiemployer plans?

Mr. McGINN. Generally familiar with it; yes.

Senator NICKLES. Were you supportive of that concept? The concept was primarily that if you had a defined contribution obligation prior to the multiemployer amendments, it would remain as such and not extend to a defined benefit obligation.

Mr. McGINN. Well, the problem with answering a question of whether or not we were supportive of the Hatch bill—under certain circumstances, that relief given by that bill would apply, and in some industries it might be totally inappropriate.

Some industries may need a degree of protection. Industries that are growing or are at least stable and have good prospects should be industries that could get substantial and significant relief from withdrawal liabilities. But I think the Hatch bill was perhaps a little bit too general.

Senator NICKLES. Incidentally, we are going to try to make reforms in multiemployer this year in this committee, and we hope to have assistance from the administration in working on that. We laid groundwork last year and hopefully are moving forward.

Do you think they should be fairly general to where they would help many of the industries who are faced with the multiemployer dilemma of withdrawal liability, et cetera?

Mr. McGINN. That is quite a question. I think that any amendments to the law should be flexible enough to attempt to recognize the unique characteristics of certain industries. There are certain industries that are very stable and have great growth potential.

At the same time, do not close your eyes to the fact that there are a number of industries that are on the decline with no foreseeable hope for a reversal. I think that any kind of legislation would have to take into account sort of a balanced view of how to handle the many, many different circumstances in which any multiemployer trust fund could find itself.

Senator NICKLES. We will have testimony in a moment that will basically say the trucking industry and the Teamsters want to be exempt. We also have other groups that will say they would like to have an exemption.

Do you think that we as a committee, or Congress, should just take those as they come, or should we try for a broader scope than that?

Mr. McGINN. It seems to me that the problem is so general that it really needs a lot of thought and a lot of consideration of many industries.

I happened in my formal statement to point out some of the problems that are affecting plans. For example, there is one plan that I mentioned that has had no unfunded vested liability whatsoever for quite a few years. It is a construction industry plan, and yet in that plan the trustees were stalemated for well over 1 year in deciding on whether or not they would grant any benefit improvements, all because of the problems of this law.

I think that is an environment which this law has created. I think another thing which the law has created is the sense among employers that whatever the law says today could be reversed tomorrow. So, if you have something to rely on today, it may not be there to lean on tomorrow, and that is of great concern to a lot of employers.

Senator NICKLES. Many of us are trying to change the law to where it will not be the same tomorrow as it is today. I think you have appropriately defined, particularly in the multiemployer field, how the law has worked counterproductively to the design or intention or admirable goals of the law.

Instead of protecting participants' assets, in many cases, or protecting their benefits, we find that it might be snuffing out the lifeblood, the new participants coming into the system, and has actually been very detrimental to those it was actually designed to assist.

Mr. McGINN. From my own personal viewpoint, I think the biggest problem is that people have viewed plans as sort of in a static state. They look at a plan and its funding and its planned design as it exists on a given date. They do not think in terms of how utterly crucial it is to maintain the underlying source of all the contributions that are going to go into that plan.

Most actuaries very often tend to be talking about mortality and disability rates and investment return rates, and a lot of technical things, and very often have not really addressed themselves to the economic side of the issue as to whether or not the contributing employers can be expected to continue as a viable organization or contributing group for many years into the future.

Senator NICKLES. Can you give me specifics on how that works?

Mr. McGINN. Well, I do have one plan, for example, where if you think in terms of the drycleaning industry, probably about a dozen years ago the drycleaning industry appeared to be thriving. Most people here, for example, would send out their suits or dresses, or what have you, to have them cleaned all the time.

But then you have the obsolescence to a great extent of that kind of an industry—a great switch to wash and wear products. We witnessed over a period of about 6 years a rate of decline in the contributing employer base by about 15 percent per year.

So, this plan was catapulted from a very, very well-funded plan to a plan that is just squeaking by as far as Federal funding standards are concerned.

Senator NICKLES. Have you seen for the two largest Teamster plans, since 1980, a reduction in the number of new participants to where you are foreseeing that if changes are not made, it could be very detrimental to those plans as well?

Mr. McGINN. I think for both of those plans, and I think it is true for almost all plans, there has been a decline in the covered membership, and I think it has been somewhat significant.

Senator NICKLES. Would you have those figures for the number of new participants coming in and what has happened?

Mr. McGINN. I do not happen to have statistics with me. I actually was developing some statistics for that purpose and concluded that the very period of time when this law has come into effect is also the period of time, primarily, when we have had the worst recession since the Great Depression.

I do not think that any actuary, without a great deal of careful research, could determine to what extent the decline in the covered membership is a direct byproduct of the problems we are talking about today or the problems of recession.

Senator NICKLES. That is a good comment. We thank you very much, Mr. McGinn, for your assistance before us today.

Our next guest is Howard Ryder, who is president of Coastal Tank Lines, and also chairman of ATA. Mr. Ryder, it is good to see you again.

STATEMENT OF HOWARD W. RYDER, PRESIDENT, COASTAL TANK LINES, AKRON, OHIO, AND VICE CHAIRMAN, BOARD OF DIRECTORS, AMERICAN TRUCKING ASSOCIATIONS, INC., ACCOMPANIED BY HERVE AITKEN, DIRECTOR, INDUSTRIAL RELATIONS DEPARTMENT, AMERICAN TRUCKING ASSOCIATIONS, INC.

Mr. RYDER. Thank you, Senator. My name is Howard Ryder. I am president of Coastal Tank Lines of Akron, Ohio, and a vice chairman of the board of directors of the American Trucking Associations.

ATA is a national trade association covering all 50 States and the District of Columbia, representing all types and kinds of regulated motor carriers as well as private fleets.

Incidentally, I am also chairman of a special committee at ATA involved in the subject of employee benefit legislation.

Senator NICKLES. I am a little confused. Are you chairman of the ATA or chairman of this committee?

Mr. RYDER. No, no. I am a vice chairman of ATA and chairman of the special committee dealing with the pension legislation.

Senator NICKLES. OK, thank you very much.

Mr. RYDER. We have a complete statement that has been supplied to the committee which we ask be incorporated into the record of this hearing. I would now like to provide a summary of that statement.

The trucking industry is very concerned about the current health and future prospects of its defined benifit pension plans, both single and multiemployer. However, because of the devastating impact with the Multiemployer Pension Plan Amendments Act of 1980 on the trucking industry, ATA's priority for reform to solve defined benefit plan problems is clearly in the multiemployer area.

We believe that the problems caused by the 1980 act, if not resolved, ultimately will lead not only to further harm of the industry, but to the demise of many of the very plans that the act was intended to protect.

No other industry has been harmed by the increased pension burdens and liabilities brought about by ERISA and MPPAA more than the trucking industry. This is because of the enactment of the Motor Carrier Reform Act in July 1980, just weeks before the enactment of MPPAA.

The Motor Carrier Reform Act of 1980 greatly encouraged new entrants into the trucking business and substantially increased rate competition. This has resulted in the growth of many nonunion carriers with lower labor costs, which in many cases are edging the unionized carriers, with their higher costs, out of the industry.

The competitive pressures of deregulation were allowed by Congress on the assumption that the trucking industry would be free under the new law to adjust its structure in response to the new business environment by merging, consolidating, reorganizing, or simply going out of business.

Unfortunately, however, MPPAA was passed just 87 days later. This prevents the trucking industry from adjusting to market circumstances brought about by the Motor Carrier Act. MPPAA fundamentally altered the ability of motor carriers to leave the industry or otherwise deal with the new competitive environment.

Indeed, the very things that the Motor Carrier Act has encouraged—buying, selling, merging, et cetera—are the triggers for withdrawal liability under MPPAA. The net effect of this has been not only the imposition of huge liabilities on companies; it has also led to a continuation of unprofitable terminals and companies, difficulty in borrowing money, and the frustration of mergers and consolidations, which in turn has resulted in lost jobs.

In summary, MPPAA detrimentally affects every major business decision in the trucking industry at a time when the Motor Carrier Act has demanded the toughest of business decisions. The conjunction of these two statutes is devastating for the unionized trucking industry.

Many firms cannot compete in the industry as they are currently structured. They cannot restructure without paying enormous withdrawal liabilities, and they cannot leave the industry without paying still greater withdrawal liabilities.

Obviously, such carriers cannot easily find buyers willing to assume not only unprofitable businesses, but also their substantial pension withdrawal liability. More often than not, they are forced to consume their assets by continuing to operate unprofitable businesses in order to avoid the withdrawal liability.

We are not alone in our perspective of the effect of MPPAA on the trucking industry. Reese Taylor, Chairman of the ICC, has noted this detrimental impact in a letter to this committee which I ask be made a part of the record at this point.

Senator NICKLES. OK.

Interstate Commerce Commission
Washington, D.C. 20423

OFFICE OF LEGISLATIVE COUNSEL

July 12, 1982

Honorable Don Nickles
Chairman
Subcommittee on Labor
Senate Committee on Labor and
Human Resources
United States Senate
Washington, D.C. 20510

Mr. Chairman:

Thank you for requesting the views of the Interstate Commerce Commission with respect to a matter of great concern--the financial plight of the trucking industry and the fact that testimony before your Subcommittee indicated the industry may be "facing serious problems stemming from deregulation and the 1980 ERISA amendments."

First, let me state that the Commission does not believe that enactment of the Motor Carrier Act of 1980 has, in and of itself, caused financial harm to the industry. Instead, it is our view that it is the downturn in the economy that has caused the decline in the industry's financial performance. For a further explanation of this matter, I am attaching the Commission's recent testimony before the House Public Works Surface Transportation Subcommittee; that statement discusses the financial status of the industry in some depth. Also, in responding to questions at the House oversight hearing on June 23, 1982, I pointed out that many of the motor carriers presently in financial difficulty had experienced losses prior to enactment of the Motor Carrier Act.

Nevertheless, the Commission is aware of the problems created by the 1980 Multiemployer Pension Plan Amendments which, in conjunction with ERISA (The Employee Retirement Income Security Act of 1974), require an employer which wholly or partially withdraws from a pension plan to pay a prorata share of unfunded vested liability.

The withdrawal liability problems created by the 1980 ERISA amendments are very real and, as demonstrated at your hearings, have interfered in a number of instances with motor carrier decisions whether to transfer, sell or liquidate part or all of their operations. This problem, we believe, needs to be addressed by Congress.

I would also agree that the problems resulting from the Multiemployer Pension Plan Amendments have been particularly severe because of the timing of those amendments. The Motor Carrier Act became effective on July 1, 1980. That legislation contemplated changes in the motor carrier industry in line with the new guidelines intended to promote competitive and efficient transportation services. Less than three months later, the Pension Plan Amendments became effective, and prevented some carriers from ceasing operations despite the fact that they found themselves unable to compete in the new and more competitive environment resulting from the Motor Carrier Act. The situation was, of course, exacerbated by poor economic conditions.

I have recently been informed that concerned parties, including the American Trucking Associations and the Teamsters, have reached agreement on a substitute version of S. 1748, the "Multiemployer Pension Plan Stabilization Act of 1981." We were extremely pleased to learn that the parties have developed a compromise approach to withdrawal liability that should resolve the problems discussed in hearings before your Subcommittee in March of this year.

Your efforts in regard to this legislation are an important factor in the progress that has been made toward a solution to these problems, and I hope that a markup will be scheduled in the near future. If the Commission can be of any assistance to you or your staff, please let me know.

Sincerely,

Reese H. Taylor, Jr.
Chairman

Mr. RYDER. MPPAA has also inhibited plan growth in our industry. The fear of withdrawal liability inhibits employers currently in the program and has hampered efforts to expand the contribution base of multiemployer plans.

Ordinarily, multiemployer plans experience periodic withdrawals of employers due to normal fluctuations in the marketplace. A plan's lifeblood depends on its ability to attract new employers into the fund and to replace the natural attrition experienced in a cyclical economy.

It has been our experience that due to concerns over withdrawal liability, multiemployer plans have not been able to attract new employers into their funds. Mr. Chairman, my complete statement contains many illustrations demonstrating the harshness and fairness which MPPAA has imposed on the trucking industry. The examples illustrate the immense harm MPPAA has inflicted on the trucking industry.

Since May 1980, 261 ICC-regulated motor carriers that had a measured presence in the trucking industry have gone out of business, filed chapter 11, or reduced their services.

Senator NICKLES. How many?

Mr. RYDER. 261.

Senator NICKLES. OK.

Mr. RYDER. These carriers represent more than $2.6 billion in annual revenues and more than 52,000 trucking jobs lost or in jeopardy. Certainly, Mr. Chairman, Congress has not been unaware of the multiemployer pension plan problem. This subcommittee held hearings on March 11, 1982 on the Multiemployer Pension Plan Stabilization Act of 1982, S. 1748, introduced by Senator Orrin Hatch.

As you recall, I representing ATA and others testified on behalf of the trucking industry and supported S. 1748. On the second day of the hearings, representatives of the Teamsters' two largest pension funds, Central States and the Western Conference Fund, opposed S. 1748, but did agree that legislative modification to MPPAA was needed for the trucking industry. They offered an alternative proposal which is similar to the exemption currently in the law for the construction and entertainment industries.

Mr. Chairman, you urged ATA, the International Brotherhood of Teamsters and the major Teamster plans to work out a compromise solution. After much deliberation, we reached agreement on a compromise solution last July. We further refined our agreement during the balance of 1982.

At this time, details are being worked out between the parties of interest in the industry on the compromise which we expect to be introduced in the near future. Our proposed approach will eliminate the current unworkable trucking industry exemption in the law and replace it with a new exemption which is somewhat similar to the construction and entertainment industries' exemption.

By its terms, motor carriers would be able to go out of business, move outside the jurisdiction of a particular plan and, in virtually all cases, sell their assets without creating withdrawal liabilities. Such an exemption would be admittedly narrow in scope. It would not solve all the problems MPPAA has created for our industry which we would want to address at a later time.

Yet, it would permit motor carriers and the trucking industry the freedom to adjust its structure to respond to the new competitive environment brought about by the Motor Carrier Act of 1980.

However, to the extent that motor carriers are relieved of their unreasonable MPPAA liabilities, our multiemployer pension plans will be greatly aided. Such plans will be able to seek out new motor carrier employers to replace those who have gone and will go out of business.

The trucking industry, its multiemployer plans and their participants have greatly been harmed by MPPAA, more than any other industry. The relief we are seeking is timely and achievable. At the appropriate time, we look forward to discussing its terms with you.

Mr. Chairman, I thank you for the opportunity to appear before you.

[The prepared statement of Mr. Ryder follows:]

STATEMENT OF

HOWARD W. RYDER

ON BEHALF OF

AMERICAN TRUCKING ASSOCIATIONS, INC.

ON

OVERSIGHT - CURRENT HEALTH AND FUTURE PROSPECTS OF DEFINED BENEFIT PENSION PLANS

BEFORE THE

SUBCOMMITTEE ON LABOR
COMMITTEE ON LABOR AND HUMAN RESOURCES
U.S. SENATE

March 21, 1983
Washington, D.C.

My name is Howard W. Ryder. I am President of Coastal Tank Lines of Akron, Ohio, and a Vice Chairman of the Board of Directors of the American Trucking Associations, Inc. (ATA). ATA is the national trade association of the trucking industry, a federation of associations in all 50 states and the District of Columbia, representing all types and kinds of regulated motor carriers as well as private fleets.

The trucking industry is very concerned about the current health and future prospects of its multiemployer pension plans. The Multiemployer Pension Plan Amendments Act of 1980 (MPPAA) has imposed "devastating" withdrawal liability problems on the trucking industry. We believe that these problems, if not resolved, ultimately will lead to the demise of many of these plans. I will not today discuss the problems our industry is having with its single employer pension plans.

THE LIABILITY CHRONOLOGY

With few exceptions, multiemployer pension plans in the trucking industry have been financially sound plans. Over the years they have proven to be a valuable protection for the transient union employee in the trucking industry, and a cost effective method for a small employer to provide pension protection for his employees. In the past, employers have been willing to join such plans because their liability was fixed by their contributions agreed to at the bargaining table. Thus, multiemployer pension plans attracted a broad base of contributors and they were healthy plans. As the record before Congress in

1974 demonstrates, multiemployer pension plans at that time were far less likely to terminate than single employer plans.[1]

In order to prevent certain isolated abuses, Congress changed the rules under which pension plans operate by enacting the Employee Retirement Income Security Act of 1974 (ERISA). What were defined contribution plans became defined benefit plans. Coverage was extended. Vesting was tightened up and made universal. Twenty-year vesting practices were reduced typically to ten years. Funding requirements were established. A plan termination insurance system began. For the first time if a multiemployer plan were terminated, each employer participating in the plan was required by law to secure at least a portion of his unfunded vested benefits. That liability was limited to 30 percent of his net worth.

After ERISA was passed, the new requirements placed significant financial burdens on multiemployer pension plans. As a result, contributions required of employers already in multiemployer plans increased. Employers who were not in multiemployer plans became reluctant to enter into such plans. Even so, the vast majority of employers already contributing to multiemployer plans stayed in and continued their commitment to make their contributions.

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[1] A U.S. Department of Labor study referenced in the record of the ERISA legislation shows that in a six-year period 79 multiemployer plans terminated out of a universe of 2,000. Nearly all of these plans involved the merger of weaker plans into larger, more stable plans. In three of the 79 plans, there were benefit losses affecting a total of 540 workers out of the eight million worker universe in the multiemployer plan system, a loss of less than one one-hundredth of a percent.

Congress further expanded the employer liability for multiemployer plans in 1980 by enacting MPPAA. The 30 percent net worth liability limitation was changed to 100 percent. Employer liability was also expanded so as to be triggered not only when a multiemployer plan terminated but also when an employer individually withdrew from a plan. The cost of carrying the unfunded vested benefit obligation on which liability is calculated was expanded by shortening amortization from forty years to thirty years. The effect of these changes was again to enlarge the debt burden which most multiemployer pension plans must carry for vested benefits.

The unfunded vested benefit obligation levels now increased dramatically -- both because of new benefit increases adopted by trustees and a shrinking in the number of new employers entering into the plans. The burden of payment for these enormous liabilities was placed, by virtue of ERISA and MPPAA, squarely on the shoulders of employers, whose liabilities previously had been defined and limited by their labor agreements. To quote one recent court opinion:

> "The MPPAA of 1980 created non-contractual liability for employers who withdraw from multiemployer plans. That liability represents a share of the pension plans' total vested unfunded liability, and is not necessarily related to the way in which the liability arose. Thus, because an employer may incur liability for the pensions of other employers' workers, withdrawal liability works as a penalty on an employer

> who withdraws from the plan." (T.I.M.E.-D.C., Inc. v. Trucking Employees of North Jersey Welfare Fund, Inc., 82 CIV 3212 (E.D.N.Y. March 7, 1983).)

Moreover, the imposition of these enormous liabilities created a great disincentive for employers to join multiemployer plans. Simply, the combination of ERISA and MPPAA has substantially increased an employee's rights and entitlements, without providing for a workable system for the payment of these benefit guarantees.

THE DEVASTATING EFFECT ON THE TRUCKING INDUSTRY

No other industry has been harmed by the increased pension burdens and liabilities brought about by ERISA and MPPAA more than the trucking industry.[2] This is because Congress enacted the Motor Carrier Act of 1980 in July which greatly encouraged new entrants into the business and substantially increased rate competition. This has resulted in the growth of many non-union carriers with lower labor costs, which in many cases are edging out of the industry the unionized carriers with their higher costs. The competitive pressures of deregulation were allowed by Congress on the assumption that the trucking industry would be free to adjust its structure in response thereto, which include the ability of existing motor carriers to merge, reorganize or simply go out of business.

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[2] For example, 48 of the first 110 court cases challenging the constitutionality of MPPAA involve the trucking industry.

MPPAA, passed 87 days later, prevents the trucking industry from adjusting to the market circumstances brought about by the Motor Carrier Act. MPPAA fundamentally altered the ability of motor carriers to leave the industry or otherwise deal with the new competitive environment. They cannot easily buy, sell, merge, or consolidate businesses. This has proven to be a severe obstacle to preserving jobs by merging companies.[3] MPPAA also has a negative impact on the movement of capital and reduces the ability of motor carriers to borrow money.

In sum, MPPAA detrimentally affects every major business decision in the trucking industry at a time when the Motor Carrier Act has demanded the toughest of business decisions. The conjunction of these two statutes is devastating for the unionized trucking industry -- many firms cannot compete in the industry as they are currently structured; they cannot restructure without paying enormous withdrawal liabilities; and they cannot leave the industry without paying still greater withdrawal liabilities. Obviously, such carriers cannot easily find buyers willing to assume not only unprofitable businesses but also their substantial pension withdrawal liability. More often than not, they are forced to consume their assets by continuing to operate unprofitable businesses in order to avoid the withdrawal liability.

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[3] Financial analyst and former Interstate Commerce Commissioner Thomas Trantum, in testimony before the Joint Economic Committee of the Congress on November 17, 1981, said: "The Multiemployer Pension Plan Amendments Act of 1980 made a partially or wholly withdrawing employer immediately liable for up to 100% of its net worth. Previously, withdrawal liability was limited to 30% of net worth over a period of time. In effect, the Amendments Act has made it very difficult for carriers to transfer assets, as well as move facilities from one area to another. As such, carriers face a new barrier in adjusting to market circumstances contrary to the intent of the Motor Carrier Act of 1980. I, therefore, urge Congress to review this matter and search for a solution."

The harshness and unfairness of the situation is graphically demonstrated in the case of Dean Truck Line, Inc., of Corinth, Mississippi. Dean was an "interline" carrier, a hauler of long-distance shipments over an intermediate segment of the trip. Because other carriers were limited in the routes over which they could operate, Dean had a virtually guaranteed market. However, with the elimination of route restrictions, larger carriers could carry the freight themselves over Dean's routes. Dean's "niche" was thus eliminated and its only alternative was to go out of business, which it did in 1981. Dean's withdrawal liability was assessed at $687,000, an amount greater than Dean's net profits for the last 20 years.

The extreme nature of this forfeiture is further demonstrated by Johnson Motor Lines of Charlotte, North Carolina. Because it was no longer profitable and had no reasonable prospect of becoming profitable, Johnson ceased operations in August, 1980. Since then, Johnson has been assessed over $20 million in withdrawal liability, far in excess of the company's net assets and also greater than Johnson's total earnings since its inception in 1945.

More recently, in April, 1982, Spector Red Ball of Dallas, Texas, the nation's seventh largest carrier at that time, was forced to file Chapter 11 due to declining business operations. Telecom, the parent company, subsequently was billed $66 million in withdrawal liability by the pension plans to which Spector Red Ball had contributed.

These examples are illustrative of scores of others which together depict the immense harm MPPAA has inflicted on the trucking industry. Since May, 1980, 261 ICC-regulated motor carriers that had a measured presence in the trucking industry have gone out of business, filed Chapter 11 or have reduced their services. These carriers represent more than 2.6 billion dollars in annual revenues, and more than 52,000 trucking jobs lost or in jeopardy.

The deterrent effect of withdrawal liability on buyers and sellers in the trucking industry is aptly demonstrated by the situation of T.I.M.E.-D.C. of Lubbock, Texas and East Texas Motor Freight Line, Inc. (ETMF) of Dallas, Texas. Because of changes in the competitive and regulatory climate, both companies became unprofitable. They entered into negotiations for the sale of T.I.M.E.-D.C.'s assets to ETMF. In 1981, T.I.M.E.-D.C. was a major motor carrier with 93 terminals and approximately 2,500 employees. Both companies estimated that because of efficiencies gained through consolidation of routes and terminals, the sale would save $14 to $18 million the companies had been losing annually and would create one profitable company in place of two unprofitable companies. Every detail of the sale had been negotiated except T.I.M.E.-D.C.'s withdrawal liability.

That last detail stopped the transaction. The two companies could not agree on how to allocate T.I.M.E.-D.C.'s estimated withdrawal liability of $29 million and ETMF could not justify the risk of assuming the liability. Consequently, an economically feasible and necessary sale was thwarted by MPPAA's pension withdrawal liability. The two companies have since lost more than $19 million. Today, in order to stay in business, T.I.M.E.-D.C. has suffered through a disastrous strike and is struggling to rebuild its operations.

In addition to ETMF, Liquid Transporters, Inc. of Louisville, Kentucky, Willett, Inc. of Chicago, Illinois, CRST, Inc. of Cedar Rapids, Iowa, Friedman's Express, Inc. of Dorrance, Pennsylvania, and Sanborn's Motor Express, Inc. of Portland, Maine have indicated that they have decided against purchasing another trucking company because of potential problems with withdrawal liability under MPPAA.

Pozas Brothers of San Jose, California, presents a situation where two brothers desire to sell their trucking company and retire. Because of the company's contingent withdrawal liability of approximately $1.3 million, they cannot find a buyer and are forced to stay in business against their will.

Even when a sale is successfully consummated, the buyer continues to be harmed, as demonstrated by Miller Transporters, Inc. of Jackson, Mississippi. In 1981, Miller purchased the assets of Wheeling Pipe Line Company and, because of the MPPAA requirements, had to post bonds totalling over

$800,000 to guarantee that it would not later reduce or close the operations it purchased from Wheeling. Since February, 1982, Miller has lost over a million dollars from the operation of Wheeling. However, Miller can't close down the operations without forfeiting $800,000 to the multiemployer plan.

As demonstrated by T.I.M.E.-D.C./ETMF, Pozas, Miller and the other motor carriers mentioned, MPPAA penalizes, or bars altogether, the sale of companies involved in multiemployer pension plans. From our list of 261 motor carriers which had gone out of business, filed for bankruptcy, or reduced services, 202 motor carriers have actually terminated their operations since mid-1980. Presumably these companies would have preferred to sell their businesses as going concerns rather than having to terminate operations and liquidate their assets piecemeal. Based on ATA's understanding of and experience with the effects of MPPAA on the trucking industry, we believe that withdrawal liability may have played a significant role in the inability of many of these companies to sell their trucking businesses as going concerns.

MPPAA detrimentally affects other business decisions in the trucking industry as attested by Oneida Motor Freight, Inc. of Carlstadt, New Jersey. Oneida closed a terminal and moved the employees to another terminal four miles away. Because the second terminal was in the jurisdiction of another pension plan, the company had to cease contributions to the pension plan originally covering its employees. The first plan assessed a withdrawal liability of $318,000, even though Oneida continues to make contributions for the same employees to the second plan.

In another situation, Lattavo Brothers, Inc. of Canton, Ohio, sought to expand its operations in Pittsburgh to offset losses elsewhere. However, because of potential withdrawal liability it could not move its employees from a terminal on one side of Pittsburgh to a terminal on the other side -- a move necessary to expand its Pittsburgh business. MPPAA thus foreclosed an opportunity that could have aided the company in reversing its business downturn.

Likewise, Friedman's Express, Inc. of Dorrance, Pennsylvania has indicated that it was precluded from relocating a facility in Newark, New Jersey to New York, largely because of potential withdrawal liability. And Tower Lines, Inc. of Wheeling, West Virginia has indicated that it did not relocate a facility largely because of potential withdrawal liability.

Finally, trucking companies are beginning to have difficulty obtaining loans because withdrawal liability represents a claim on the company's assets.[4] John Cooley, President of the Merchandise National Bank of Chicago, has stated:

> "The Multiemployer Pension Plan Amendments Act of 1980 has created a significant risk in the lending of money to any trucking company which contributes to a multiemployer

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[4] Many accounting firms are requiring the footnoting of withdrawal liability on trucking company financial statements.

> plan. If a trucking company goes out of business, the fund to which the company contributed is a general creditor, up to 50% of the company's assets, on equal standing with all other general creditors. As a consequence, Merchandise Bank must assess this additional risk in making any loans to trucking companies. Unless a trucking company has an extraordinary strong balance sheet or has little 'withdrawal liability,' as a matter of prudent banking policy, Merchandise Bank must require security for a loan it otherwise would have made as an unsecured loan, charge a higher rate of interest in order to compensate for the greater risk, or decline to make the loan."

The Pension Benefit Guaranty Corporation (PBGC) has made it clear that no business transaction, however structured, is forever clear from the imposition of withdrawal liability. In a letter to a representative of a potential buyer of a trucking company,[5] the PBGC General Counsel said:

> "The PBGC will, however, continue its practice of issuing general interpretations of the law. In this regard, with respect to your inquiries, it is clear that under the Act, where the stock of an employer is sold, and the corporation continues to contribute to the plan, there is no withdrawal under section 4203. However, it does not necessarily follow from this that the seller of the stock is forever clear of any liability to the plan. Section 4212(c) of ERISA provides that '[i]f a principal purpose of any transaction is to evade or avoid liability under this part, this part shall be applied (and liability shall be determined and collected) without regard to such transaction.' Thus, in the event of the employer's subsequent withdrawal from

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[5] Letter sent to Mr. Clifford M. Govaerts, dated November 24, 1981.

> the plan, the plan sponsor might, if the facts warranted it, seek to assert liability against the seller of the employer stock."

THE REMEDY

Congress has not been unaware of the trucking industry's multiemployer pension plan problem. This Subcommittee held hearings on March 11 and 17, 1982 on the Multiemployer Pension Plan Stabilization Act of 1982 (S. 1748) introduced by Senator Orrin Hatch (R-Utah). I would like to commend you, Mr. Chairman, for the leadership you have evidenced in addressing our problem.

S. 1748 would have removed all trucking industry multiemployer plans from the withdrawal liability provisions of MPPAA. ATA testified before you on behalf of the trucking industry and supported S. 1748. On the second day of hearings, representatives of the Teamsters' two largest pension funds, the Central States and the Western Conference Funds, opposed S. 1748, but agreed that legislative modification to MPPAA was needed for the trucking industry. They offered an alternative proposal which is similar to the exception currently in the law for the construction and entertainment industries.

Mr. Chairman, you urged the ATA, the International Brotherhood of Teamsters and the major Teamster plans to work out a compromise position. After much deliberation, we reached agreement on a compromise solution in July, 1982. We further refined our agreement during the balance of 1982. Senator David Durenberger (R-Minn.) is expected to introduce a bill which represents the ATA/Teamster compromise. The compromise would eliminate the current ineffectual trucking industry exemption in the law and replace it with a new exemption which is somewhat similar to the construction and entertainment industries exemption. By its terms, motor carriers would be able to go out of business, move outside the jurisdiction of a particular plan, and in virtually all cases sell their assets without creating withdrawal liability.

In addition, the amendment provides a liability cap of 106 percent of the preceding year's contributions for each individual motor carrier in the event a plan experiences a funding deficiency. This would encourage employers in troubled plans to remain with the plan.

The exemption is narrow in scope. It would not solve all of the problems MPPAA has created for our industry. Yet it would permit motor carriers and the trucking industry the freedom to adjust its structure to respond to the new competitive environment brought about by the Motor Carrier Act of 1980. Moreover, to the extent that motor carriers are relieved of their unreasonable MPPAA liabilities, our multiemployer pension plans will be greatly aided. Such plans will be able to seek out new motor carrier employers to replace those who have and will go out of business. And not insignificantly, the extensive administrative costs which the plans to which we contribute have expended to date to enforce MPPAA's provisions will be substantially eliminated.

Mr. Chairman, in closing I would like to state that I am aware that employers in other industries less affected by

MPPAA than the trucking industry have expressed their concern that, if Congress were to enact the trucking industry's compromise bill, they will be less likely to obtain any legislative relief for themselves. Please do not hold the trucking industry hostage to their concerns. We have been the hardest hit by the 1980 pension law. The trucking industry desperately needs the legislative relief we have worked out now.

ATA urges you and your committee to initiate favorable action on the ATA/Teamster solution.

Senator Nickles. Thank you again, Mr. Ryder for your appearance before this committee. You and the ATA have done extensive work with Teamsters in trying to come up with something that both parties can work on.

I will repeat as I did last year that I think you have well illustrated, and you had several examples in your statement, the necessity for multiemployer reform. I am very, very aware of that, as I would imagine a great number of Senators are.

I am very much in hope that we can move forward on something this year. I would also hope that it would be a more comprehensive proposal than what has been agreed upon by ATA and the Teamsters; I would like to see it more multiemployer industrywide.

You mentioned in your statement that 261 carriers have gone bankrupt in the last 2 years?

Mr. Ryder. Yes.

Senator Nickles. They went out of business in the last 2 years?

Mr. Ryder. Since MPPAA.

Senator Nickles. All of those have received a withdrawal liability, is that correct?

Mr. Ryder. Yes.

Senator Nickles. Do you have any knowledge of the number of dollars of that withdrawal liability?

Mr. Ryder. Well, I do not have it in total, but I can reveal some information that we have picked up from the Central States Teamster pension plan. Their total withdrawal liability notices issued during this period of time, just out of the Central States Fund, amounted to $220 million.

Senator Nickles. Just the Central States is $220 million?

Mr. Ryder. Right.

Senator Nickles. How many carriers were out of Central States? These are all motor carriers, I believe, are they not?

Mr. Aitken. Yes; they are. Mr. Chairman, my name is Herve Aitken. They are motor carriers. We cannot tell you exactly how many are out of the Central States area. I would guess that a majority of those carriers would be out of the Central States because of the large geographic size of the Central States plan, which covers not only the central States area, but also the Southeast and Southwest parts of this country.

Senator NICKLES. Out of the 261, a large portion of those 261 came out of Central States. And you said they sent out notices of withdrawal liability of $220 million, is that correct?

Mr. RYDER. Yes.

Senator NICKLES. Do you have any idea of the amount of that, if any of it, has been collected?

Mr. RYDER. Of that amount, $152,000 is in escrow.

Senator NICKLES. $152,000?

Mr. RYDER. Yes; and approximately $1.6 million is covered by various bonds; $236,000 represents cash moneys that were received by Central States.

Senator NICKLES. To date, the withdrawal liability provisions have not been very successful?

Mr. RYDER. All it has done is led to a great deal of litigation.

Senator NICKLES. We previously had one of the actuaries for Central States. Do you have any comments on how the withdrawal liabilities have been calculated?

Mr. RYDER. No; I do not.

Senator NICKLES. You mentioned that they were in various stages of litigation.

Mr. RYDER. Most of the ones that we are aware of have ended up in litigation. I recognize that before it can end up in litigation, it should, and they do, go through some arbitration proceedings where the issue or the question of computation of the withdrawal liability would be probably discussed and resolved, hopefully.

But there are many lawsuits that have been filed, testing the constitutionality of MPPAA, the ability of Congress to enact MPPAA and to impose a liability on motor carriers who, frankly, had not bargained for that compromise or that liability in their collective bargaining agreements.

Senator NICKLES. Mr. Aitken, do you know the status of that?

Mr. AITKEN. Yes, Mr. Chairman. There are more than 130 suits that have been filed challenging the constitutionality of the act. There have been several district court decisions. There have been no court of appeals decisions.

We at ATA have a case which has been filed in the southern district of Mississippi. That case will be argued on cross motion for summary judgment on May 13 of this year.

Senator NICKLES. Are you aware of other multiemployer industries aside from the trucking industry that have taken that approach?

Mr. AITKEN. Which approach is that, Mr. Chairman?

Senator NICKLES. To go to court to determine whether or not the Multiemployer Act was unconstitutional.

Mr. AITKEN. Yes; at the last count—we maintain a clearinghouse—of the first 110 cases filed, 48 were trucking industry cases. So, obviously, there are a number of other industries that have been impacted.

However, those numbers indicate clearly, we think, the immense harm the withdrawal liability provisions have inflicted on the trucking industry.

Senator NICKLES. I would certainly agree that there has been a considerable amount of negative impact on all participants in the trucking industry—participants in the multiemployer plans. But I would also use that as another argument to say there are many other industries that have had some negative impacts that are also looking for relief also.

We will probably discuss this further when we get into your legislation, but certainly if you supported 1748 from last year, then you are not really opposed to some other more general multiemployer reform.

Mr. Ryder. No; Senator, the only problem we really have is time. We have spent a lot of time on this question. Our industry is being harmed every day; it is not getting any better out there. In fact, if anything, it has gotten worse in the last year. The trucking industry desperately needs relief.

Mr. Aitken. If I may add to that, Mr. Chairman, the trucking industry's program is really a two-pronged approach. We have a precedent in the current law for an exemption from withdrawal liability that simply is not working. And we will be here shortly simply trying to improve that precedent.

In the long term, we would be fully supportive of a broader approach. Because of the immense harm that the act has inflicted on the trucking industry, because of the connection with deregulation, we will be here shortly asking to improve that current unworkable exemption.

Senator Nickles. Mr. Ryder, could you relate to the subcommittee your own personal involvement with the 1980 act?

Mr. Ryder. The one that comes to mind is that we are party to the Southwestern Pennsylvania Area Teamster Pension Plan and Trust with one terminal in the Pittsburgh area. That terminal employs about 60 drivers and 12 mechanics.

Because of competitive pressures brought about by nonunion operations, we would have closed that terminal as much as 18 months ago. However, we have determined that our withdrawal liability would amount to some $884,000. For that amount of withdrawal liability, we have kept the terminal open, reduced the work force, and frankly are limping along.

Senator Nickles. $884,000 was your withdrawal liability?

Mr. Ryder. Yes.

Senator Nickles. And you had 60 participants?

Mr. Ryder. Seventy-two.

Senator Nickles. For an average figure of about $12,000 per employee?

Mr. Ryder. Approximately, in that particular plan, yes.

Senator Nickles. Is the withdrawal liability done pretty much on "here is the unfunded liability of the Central States Plan, and the number of participants, and so that figure is out so much per head?"

Mr. Ryder. Well, it is based on the ratio of our contribution into the plan to the total contributions into the plan, measuring that fraction against the total withdrawal liability or the unfunded vested benefits of that plan.

Senator Nickles. Do you think that is an equitable distribution?

Mr. Ryder. No; I do not. As an illustration—this has not happened in our company, but Pittsburgh happens to be an area where they have two pension funds, one on the south side of town and one on the north side of town.

A company that I am familiar with, and I believe it is in our statement, closed its doors on the north side of town and wanted to move to the south side of town. It moved its employees and contracted a withdrawal liability out of the first plan while it continued to make payments in the second plan for those very same employees.

Now, that just does not seem fair. There is no portability between the plans.

Senator NICKLES. No portability between which two plans?

Mr. RYDER. Between any of the multiemployer plans. In other words, if you move your employees out of one multiemployer plan into another multiemployer plan, you trigger employer liability when you move out of the first multiemployer plan, despite the fact that those very same employees are covered under a pension program in the second multiemployer plan.

Senator NICKLES. Are those both in Central States in your example?

Mr. RYDER. No, no.

Senator NICKLES. What two plans were involved?

Mr. RYDER. Well, I only know the name of one of them, but one is a plan that I just described that we did not want to move out of, and that was the Southwestern Pennsylvania Area Teamsters Pension Plan and Trust.

There are some 30 multiemployer pension plans that the trucking industry is involved in. The two largest are Central States and the Western Fund. But particularly in the area east of the Ohio-Pennsylvania line, there are a number of small multiemployer pension plans, and this is where you can run into that problem where if you move a terminal and your employees are still covered by a pension and you continue to make your contribution into another pension plan, you still trigger a withdrawal liability from the plan that you move out of, because the withdrawal liability is based on moving out of a plan.

Senator NICKLES. On the point of signing a union agreement but not being required to contribute to a Teamster pension plan, how do you interpret this on the future of that plan?

Mr. RYDER. You mean the one that was moved out of?

Senator NICKLES. Yes.

Mr. RYDER. I do not believe that our removal from that plan would immeasurably harm that plan. I understand that when employee participants leave a plan, unfunded vested benefits of the plan are reduced by an amount related to the departing participants. At the same time, I do not think that we should have to pay twice for pensions for our employees.

Senator NICKLES. Do you think the real losers in this whole circle will be the employees?

Mr. RYDER. Yes, I do; since MPPAA, we in our company have set up six new terminals.

Senator NICKLES. You have set up what?

Mr. RYDER. Six new trucking terminals.

Senator NICKLES. Yes.

Mr. RYDER. Four of those terminals are nonunion. And, where we do have new terminals, we are setting them up as nonunion so we do not get involved in the multiemployer problem.

At two of those six terminals, when we negotiated our contract with the union we specifically stated, and were successful, in not having our new employees participate in the multiemployer plan, and have covered them under our own single employer defined benefit program.

Senator **Nickles**. Did you go into defined benefit or defined contribution? I am just wondering.

Mr. **Ryder**. We went into defined benefit, but currently we are terminating our defined benefit plan and are planning to move into a defined contribution program.

Senator **Nickles**. I appreciate the insight of your actual experiences, and Mr. Aitken, your appearance before the committee. Thanks again for appearing before our committee.

Mr. **Ryder**. Thank you.

Senator **Nickles**. Our next and final panelist is Paul Bell, president of P. B. Bell Co., general contracting, in Houston, Tex., representing the Associated General Contractors of America.

Mr. Bell, welcome.

STATEMENT OF PAUL G. BELL, PRESIDENT, P. G. BELL CO., GENERAL CONTRACTING, HOUSTON, TEX., ON BEHALF OF THE ASSOCIATED GENERAL CONTRACTORS OF AMERICA, ACCOMPANIED BY DENNIS BRADSHAW AND DAN KNISE, STAFF MEMBERS, ASSOCIATED GENERAL CONTRACTORS OF AMERICA

Mr. **Bell**. Thank you, Mr. Chairman. These gentlemen with me here are Dan Knise and Dennis Bradshaw from the AGC staff.

My company has been a contributor to multiemployer plans in the construction industry for over 20 years. I have served as both a managment negotiator and a plan trustee.

When our company first agreed to be a contributor to these plans, it was as a part of a collective bargaining agreement with the local building trades. What we agreed to go into was a defined contribution plan. This meant that we agreed that each time an employee of ours who was a participant in that plan worked an hour, we paid a certain number of cents into the plan. This was understood by all concerned—the unions, the employers, and the employees.

With ERISA, Congress unilaterally changed all those plans to defined benefit plans. What they said was that because we had the misfortune to be a contributor to those plans, if certain circumstances occurred we could now be liable for a portion of the vested benefits of that plan. Well, this was obviously a whole new ball game.

The potential for, and the actual assessment of withdrawal liability has put many AGC members and other contractors who are contributors on the horns of a dilemma. If market or other forces cause us to be in the position to have to withdraw from the plan, we are faced with the potential of having to give up our assets to meet these withdrawal liabilities. Yet, if we stay in the plan, we cannot continue in business either. So, this has created a real problem.

Additionally, we now have some of the folks in the accounting business coming along and saying that because there is a possibility of potential withdrawal liability, we have got to show that on our financial statements. Well, that may not be a problem for International Harvester, but it is a real problem for the average construction contractor in the United States to show on his balance sheet, and it scares the pants off of his bonding company and his banker.

After all, if those folks are so psychic about this sort of thing, can they tell whether or not you are going to have a divorce and have to split up your assets?

At the same time, we have the problem of an increasing number of contractors who simply do not participate in contributing to these plans. I can give you a specific example of what has happened in Houston, Tex.

In 1974, at the time ERISA was passed, there were about 80,000 total employees in the construction industry in Houston. About 40,000, or about 50 percent of those people, were covered by pension plans that were maintained under collective bargaining agreements.

Today, in Houston, Tex., there are about 160,000 people in the total construction force, and there are still only 40,000 workers covered by collective bargaining pension plans. Well, it obviously tells you that the new employers, people who start new companies, do not want to get involved with a pension plan for the fear of this liability.

Senator NICKLES. Excuse me. They do not want to get involved in the pension plan?

Mr. BELL. In the pension plan because of the potential liabilities that they might have as a contributor to a multiemployer pension plan.

Senator NICKLES. Or do not want to get involved in a multiemployer pension plan?

Mr. BELL. In other words, they do not want to sign a collective bargaining agreement because it says that they are going to be a contributor to a multiemployer plan, and therefore pick up liabilities.

Senator NICKLES. OK.

Mr. BELL. We are seeing another phenomenon around the country, and that is a situation where an employer who hires people who belong to unions goes into an area where there is a poorly funded pension plan. He is able to negotiate with the local building trades an agreement which says that he will do everything that the contract calls for, except he will not be required to contribute to those pension plans.

In other words, this is a realization on the part of the local building trades that they do have a plan that is in bad shape, but they want to be sure that this new employer employs their men. So, they are agreeing to allow him not to make contributions to the multiemployer plan.

What we are seeing is that people do not want to be in the position of having some trustees of a plan that may be well funded today make changes in benefits which will create new vested liabilities, and therefore create a liability for the contributor.

AGC has worked very hard at trying to develop some information in this regard. This has been a very difficult problem, as you can gather from listening to the testimony here today. Nobody really knows exactly how bad this unfunded vested liability problem is. I think we have probably got the best information that is available, and I believe this has already been made available; if not, it will be.

We think there are about 1,000 plans out there in the construction industry. We have gotten some information on over 600 of them, and specific information on 419 of them. We think that about 50 percent of the plans in the construction industry are properly funded. However, in the balance there are some very, very serious problems.

We are planning to come out with an amended inventory this fall, and we hope that we will have some additional information by then. However, one of the things that bothers us about the 50 percent of the plans which now appear to be in good shape is that there is a declining construction volume in the country, which obviously would mean declining contributions to these plans. And there is an increasing amount of construction work being done on an open-shop basis; in other words, by people who do not contribute to these plans. So, there is the potential for getting some bad news when we get additional information.

We presume that it was the intention of Congress when they passed ERISA and the 1980 amendments to try to preserve multiemployer plans. We are not at all sure that Congress goals have been met, and with the decreasing amount of interest and participation in these plans, many of them may not survive.

We have already seen a movement to replace traditional defined benefit plans with defined contribution plans. This is happening in California, Hawaii, Arizona, and Texas. People are taking whatever steps they can to properly fund the existing defined benefit plan and go into a defined contribution plan. We expect to see this grow.

ERISA and the amendments have definitely increased the cost of administering these plans. As an example, the carpenters' pension plan in Houston has seen administrative costs increase over 800 percent since 1974.

Despite the fact that many of these plans are well funded, there is still great concern and potential for millions of dollars of liability. It threatens the future of many currently contributing employers and is preventing these plans from attracting new contributors.

If these plans fail and there is not enough money coming out of withdrawn employers, who is going to pick up the tab? I gather that this is the question that Congress must be asking at the present time.

AGC has been working with some 20 trade associations in other industries to try to develop a legislative program to deal with these problems. We want to protect the interests of the affected workers; we want to protect our own interests. We are convinced that the best thing to do is to try to develop some legislative solution which would see to it that the plans are properly funded.

Certainly, if this can be done and we are happy and the employees are properly taken care of, Congress would be in the very nice position of looking after all its constituents. We look forward to returning to you at some time in the near future with this proposal, and working together with you on it.

Thank you for having me here.

Senator NICKLES. Thank you, Mr. Bell. You mentioned this survey. Would you submit a copy of the survey that we could include for the record?

Mr. BELL. Yes.

Senator NICKLES. I thank you for that.

[The prepared statement of Mr. Bell and the material referred to follows:]

TESTIMONY OF

PAUL G. BELL

FOR

THE ASSOCIATED GENERAL CONTRACTORS OF AMERICA

BEFORE THE

SENATE LABOR SUBCOMMITTEE

March 21, 1983

OVERSIGHT HEARINGS ON DEFINED BENEFIT PENSION PLANS

AGC is:

- More than 32,000 firms including 8,500 of America's leading general contracting firms responsible for the employment of 3,400,000-plus employees;
- 112 chapters nationwide;
- More than 80% of America's contract construction of commercial buildings, highways, industrial and municipal-utility facilities;
- Over $100 billion of construction volume annually.

Today this subcommittee is addressing a most important issue - "the current health and future prospects of defined benefit pension plans." AGC joins the Congress in its concern about the state of this nation's private retirement system and commends the subcommittee's foresight in scheduling these hearings. Although serious issues relating to both single and multiemployer pension plans are being considered today, AGC believes that there is none more pressing than the very serious problems which have been created by the Employee Retirement Income Security Act of 1974 (ERISA) and the 1980 multiemployer amendments to ERISA.

AGC Policy

AGC, as have many other groups, has invested a great deal of time and effort assisting its members in coping with the burdens of ERISA and the 1980 multiemployer amendments. Throughout this period, our activities have been guided by AGC's policy on ERISA and multiemployer pension plans. That policy states:

".... AGC recognizes that there are many employees of its member firms who look to multiemployer plans for retirement income. AGC believes that trustees of plans with unfunded liabilities should eliminate those liabilities by maintaining or decreasing existing benefit levels, by increasing payments into the plans, and by adding new benefits only when the plans are properly funded and only when the new benefits are completely financed through existing or increased payments to the plans."

As our policy indicates AGC fully supports the need to provide retirement income protection for employees after there has been agreement in the collective bargaining process. AGC's policy has been guided by an over-riding concern to ensure that workers will receive their promised benefits. AGC contractors, however refer to "defined benefit" multiemployer pension plans with great reluctance. "Defined benefit" pension plans are plans where the employers are responsible for the vested benefits of covered workers.

We were in 1974 and 1980, and are today, of the opinion that had Congress fully understood the operation of multiemployer plans when it considered ERISA, such plans would continue, as they were for more than thirty years before ERISA's enactment, to be considered defined contribution plans. "Defined contribution" plans are plans where the employer is only responsible for making the agreed-to contributions.

Background

Multiemployer plans have been in existence for more than 50 years. At first, these plans were established and administered solely by the unions with an employer's obligation limited only to his agreed-to per hour contribution. In 1947, Congress enacted, as a result of concern over abuse and improper administration, a provision requiring that there be an equal number of management and labor trustees controlling the operation of each multiemployer pension plan. Thus, employers were required by Taft-Hartley to participate in decisions on benefit levels, fund investment and plan administration. Although required to participate, employers generally assumed an inactive role in the administration of these plans when compared to their union counterparts. The clear understanding of all concerned, including the unions, covered workers, and contributing employers, was that the employers' only obligation was to make the agreed upon per-hour contribution. In other words, the plans were defined-contribution plans.

Throughout this period, more than 2,200 multiemployer plans were established as the mechanism to provide retirement income protection for more than 8.3 million workers. In construction alone, over 1,000 multiemployer plans, covering more than 2.4 million workers, came into existence by 1979. From my own personal experience, I would add that in more than 30 years of involvement with multiemployer plans at both the local and national level, I have never known of one construction worker who has been denied a rightfully earned retirement benefit because of a multiemployer plan termination or insolvency. Nor has there been a "rush to the door" of employers leaving these plans. The often-referred to "last man's out club" we heard so much about during the debate over the 1980 multiemployer amendments was more myth than reality. Only recently, and as a result of ERISA and the 1980 multiemployer amendments, have employers been given reason to avoid these plans.

Congressman Erlenborn correctly depicted the effect of ERISA and the enactment of the 1980 multiemployer amendments when he referred, during House debate, to the Congressional axiom "if it ain't broke, fix it." Just as Congressman Erlenborn perceived, the multiemployer pension plan system was working in our industry and in most industries with relatively few exceptions prior to enactment of ERISA. Unfortunately, Congress chose to ignore Congressman Erlenborn's advice and the pleadings of AGC and many other groups and still attempted to "fix" multiemployer plans. They may have in the final analysis only made things worse.

AGC believes that the ultimate solution would be to turn back the clock and return construction industry multiemployer plans to their pre-ERISA status as defined contribution plans. Unfortunately, time, publicity, and political considerations have eliminated that possibility. Nevertheless it is apparent that something must be done if we are to ensure the continued utilization and growth of existing multiemployer pension plans.

The Advantages of Today's Defined Benefit Multiemployer Pension Plans

There are numerous advantages associated with multiemployer pension plans. Covered workers are provided with an extra measure of security for their retirement income with risks spread among a number of employers, and, in some cases, among a number of industries. Workers also benefit from the ability of plan trustees or bargainers under appropriate circumstances to provide substantial benefit increases even for those at or near retirement age by improving past service benefits. In addition, workers enjoy a measure of portability far beyond that enjoyed by workers covered by the typical single-employer pension plan. Many construction industry multiemployer plans cover wide geographic areas allowing construction workers to freely move from job-to-job and employer-to-employer as required in our highly mobile industry, without a loss of benefits.

Construction employers have also gained as a result of the existence of multiemployer pension plans. It has been easier to attract and maintain a productive, skilled workforce with covered workers confident that an adequate pension would be available at retirement. In addition, contractors have traditionally been able to rely on a specified per hour pension cost (i.e., the agreed-to per hour contribution) in establishing prospective costs when bidding on projects. The bidding process requires contractors to estimate future labor and material costs, and the margin for error is slim. A specified wage and fringe cost (including pensions) is critical to the bidding process and continued vitality of our industry.

Lastly, multiemployer pension plans provide the opportunity for reduced administrative costs and the potential for enhanced investment resulting from the pooling of contractors' contributions.

The Problems Created by ERISA and The 1980 Multiemployer Amendments

The most serious problem created by ERISA, as amended by the 1980 multiemployer amendments, is the potential for, and actual assessment of, employer withdrawal liability. Testimony before this subcommittee during the 97th Congress illustrated that employer withdrawal liability frequently runs into the hundreds of thousands and even millions of dollars, often exceeding the net worth of the withdrawn employer. Such "horror stories," and there are literally hundreds of them, are important to a thorough understanding of our current pension plan problems. Yet the horror stories represent only symptoms of the deeper ills burdening defined benefit multiemployer plans, contributing employers, and covered workers. I would like to highlight the underlying problems which are threatening these plans and the pensions of more than eight million American workers.

Given the potential in many industries for large amounts of withdrawal liability which can be incurred solely as a result of changing market conditions, selling a business, bankruptcy or owner retirement, many, if not most, employers are avoiding participation in defined benefit multiemployer pension plans wherever possible. This failure to participate will result in an ever decreasing contribution base and a worsening financial status for multiemployer plans. This unwillingness to participate is exacerbated by the fact that multiemployer plans do not allow the typical contributing employer to control the size of his potential liability. In most instances, the responsibility for the setting of benefit levels, establishing of interest rates and actuarial assumptions, and investing of plan funds rest with an independent board of trustees. Trustees under law are obligated to act "only in the interest of plan participants and beneficiaries." Unfortunately, trustees often interpret this to mean that the level of unfunded vested liability and employer withdrawal liability must be given little, if any, consideration when deciding on benefit increase proposals.

AGC has conducted an inventory of construction industry multiemployer pension plans to determine the level of unfunded vested liability. Our report, released just a few weeks ago, contains information on over 600 construction industry plans. Based on the Pension Benefit Guaranty Corporation's (PBGC's) census information for construction industry multiemployer plans, our inventory includes about 60% of such plans. We have as a result of our inventory, precise information regarding the financial status of 419 multiemployer plans in the construction industry.

The information derived from an analysis of the inventory data is enlightening. For example, Table I below summarizes the funding status of multiemployer plans included in the inventory.

Table I

Construction Industry Multiemployer Pension Plan
Funding Status
(419 Plans)

Ratio of Plan Assets To Vested Benefits	Percentage of Plans	Number of Plans
0.9 or more	49.4%	207
less than 0.9 but not less than 0.7	22.7%	95
less than 0.7 but not less than 0.5	17.9%	75
less than 0.5	10.0%	42

We have found that almost 50 percent of construction industry multiemployer plans appear to be well funded. Specifically, an analysis of the inventory reveals that 48.7 percent of the construction industry plans in our sample are fully-funded (i.e., have sufficient assets to cover vested benefits). On the other end of the spectrum, only 10.0 percent of the plans in our sample were poorly funded (i.e., had an assets to vested benefit ratio of .5 or less). These findings support our position that most plans were not, and are not, in financial danger. Most plans are so well financed that the exit of any one contributing employer puts neither the covered employees nor the Pension Benefit Guaranty Corporation (PBGC) in any danger. The greater danger to both PBGC and to covered workers is the reality that the potential for employer withdrawal liability is preventing many new employers from participating in these plans. We have talked to various plan trustees and administrators who contend that the 1980 amendments are keeping new employers away even though their plans are, in many cases, well-funded. Thus, the vital lifeline of multiemployer plans is being broken.

Employers are also avoiding involvement in multiemployer plans because of a legitimate concern over their bonding and credit capacity. Some banks are currently asking AGC-member contractors about their involvement in multiemployer plans before granting loans or extending lines of credit. This problem will only worsen in a few months when the Financial Accounting Standards Board (FASB) issues its draft "discussion memorandum" for employer accounting of multiemployer pension plan costs. FASB has already established a precedent by holding in their preliminary views on single employer plan accounting that the employer must include "net pension costs" in financial statements. A similar approach to multiemployer plans will only serve to further discourage involvement with, and contributions to, defined benefit multiemployer plans.

ERISA and the 1980 multiemployer amendments are also causing another phenomenom. Employers and unions are sitting down, either at the bargaining table or at the trustees' table, and agreeing to convert their current defined benefit multiemployer plan to a defined-contribution plan. Already multiemployer plans in California, Hawaii, and Texas have converted to a defined contribution plan and discussions are taking place in several other locales. In and of itself, this trend should not be disturbing since defined contribution plans offer many advantages. However, the reason we are, and Congress should be concerned is that the growing number of conversions are not taking place after a thoughtful comparison of the intrinsic advantages of each type of plan, but instead occuring only as a result of the existence of potential employer withdrawal liability. We believe that choosing the best vehicle for providing retirement income protection should be a deliberate well-reasoned decision. Congress apparently intended to protect multiemployer plans as we currently know them when it enacted ERISA and the 1980 amendments. Unfortunately experience would suggest that ERISA has caused just the opposite.

The 1980 amendments are also causing labor-management friction at a time when we should be working together with labor to resolve mutual problems impacting productivity and efficiency. The traditional cooperative attitude at plan trustee meetings is giving way to increased conflict and disagreement. Already construction industry plans in

Texas, Florida, and California have been forced to arbitrate an impasse regarding a benefit increase proposal.

Administrative expenses are also excessive as a result of ERISA and the 1980 multiemployer amendments. One plan in Louisiana experienced a sixty-six percent (66%) increase in consultant costs and has been notified that these costs "will continue to escalate as a result of the adoption of the Multiemployer Pension Plan Amendments Act of 1980." The procedures for determining whether a withdrawal has occurred and for calculating and collecting withdrawal liability are complex and costly. In addition, many plans have been burdened with substantial arbitration and litigation costs.

Fortunately, Congress was persuaded in 1980 to recognize that the construction industry is somewhat unique. The construction industry is covered by a special rule which limits the circumstances under which the typical construction employer would trigger withdrawal liability. These rules are an accurate reflection of the realities of our highly mobile, geographically diverse industry and without them, our industry would be in a shambles.

There is however, still reason for concern. The possibility for withdrawal liability exists, particularly in light of our ever-changing market conditions. This is discouraging new employers from participation in these plans. This affects the future health of these plans and increases the cost burden on currently contributing employers. In addition, this potential for liability will severely impact contractors' bonding and credit capacity if the FASB requires notation on the financial statement. This issue may be even more serious for contractors than others given the critical importance of bonding capacity.

Also, the construction industry withdrawal rules apply automatically only to so-called construction industry plans. Non-construction plans, such as the Teamster plans, may voluntarily elect to apply such rules. Fortunately, the two largest Teamster plans (Central States and Western Conference) have chosen to apply versions of the construction rule to contributing construction employers. However, a number of Teamsters plans to which AGC-contractor members contribute have not adopted these rules. Contractors contributing to such plans face a much greater probability of being assessed withdrawal liability.

In summary, we are concerned that defined-benefit multiemployer plans may not survive in our industry. These plans have for years been an effective retirement income vehicle and we encourage you to remove the artificial barriers which continue to threaten their existence and continued growth.

AGC's search for lasting solutions to the myriad of problems caused by ERISA and the 1980 multiemployer amendments provided the impetus for AGC to play a leading role in the formation of a broad-based employer coalition comprised of employers in the construction, stevedoring, meat-packing, printing, warehousing, retail and wholesale grocery, food-processing and apparel manufacturing industries. The ad hoc coalition has been working for more than a year to devise a legislative solution to this complex problem. The solution finally developed attempts to meet the needs of as many of the involved groups as possible and at the same time establish an environment where defined benefit pension plans will survive and prosper. We look forward to a future opportunity to share the details of this proposal with you.

Thank you for the opportunity to present our views.

Fringe Benefits Bulletin

#6-83

THE ASSOCIATED GENERAL CONTRACTORS OF AMERICA
1957 E Street, N.W. Washington, D.C. 20006 393-2040

Route to:
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February 22, 1983

TO: Members of the Collective Bargaining Committee and Chapter Managers

SUBJECT: AGC's Pension Plan Inventory

Attached for your information and use is AGC's update of its "Inventory of Construction Industry Multiemployer Pension Plans." This report contains information on over 650 multiemployer pension plans and includes, in addition to specific funding and contribution information on each plan, an analysis of interest rate assumptions utilized by the plans and the size (as measured by active employees) of construction industry plans.

AGC's inventory effort represents only one facet of AGC's broad involvement in multiemployer ERISA activities. AGC has also published a 69-page manual entitled "How the 1980 Multiemployer Amendments to ERISA Affect the Construction Industry" and has gathered and published information on the legal challenges to the 1980 amendments and the alternatives for minimizing unfunded vested liability such as converson to a defined-contribution plan. AGC is also actively pursuing legislative modification of the 1980 multiemployer amendments.

A limited number of additional copies of the pension plan inventory are available to AGC members and chapters on request. Non-AGC members may also order copies of the report at a cost of $5.00 per copy to cover printing, postage, and handling.

Sincerely,

Dan Knise

Dan Knise, Director
Collective Bargaining Services

BUILDING
AMERICA

AGC CONVENTION
CONSTRUCTOR EXPOSITION
March 13-15, 1983 Atlanta, GA

Attachment

INVENTORY OF CONSTRUCTION INDUSTRY MULTIEMPLOYER PENSION PLANS

Associated General Contractors of America
1957 E St. NW
Washington, D.C. 20006

AGC PENSION PLAN INVENTORY

February 1983

INTRODUCTION

With the enactment of the Multiemployer Pension Plan Amendments Act of 1980, it became essential that contractors be aware of, and take an active interest in, the financial health of multiemployer pension plans. The current level of unfunded vested liability (UVL) as well as the upward or downward trend of liability are particularly important pieces of information.

This need for more and better data led AGC to undertake an inventory of construction industry multiemployer pension plans. Under the guidance of the ERISA Task Force, AGC has been attempting to gather information on as many of the more than 1,000 construction industry plans (according to PBGC) as possible.

This report represents a vastly expanded version of AGC's interim report of almost 200 construction industry multiemployer pension plans that was released in July, 1982 (see Fringe Benefit Bulletin #18-82). This current report contains information on over 650 plans that contractors contribute to. While this survey does not include all of the construction industry related multiemployer plans, it does include most of the larger plans and appears to provide a fairly representative sample of construction industry multiemployer pension plans.

PROBLEMS IN DATA COLLECTION

The data contained in this report was extracted from information provided by two sources. A majority of this data was extracted from computer printouts purchased from a private research firm that specializes in collecting pension fund data. A good deal of information was also obtained from a number of AGC chapters from across the country. Most of the data contained in the survey is based upon information that was reported on Form 5500 and Form 5500 - Schedule B for years 1978-79, although in some instances the information provided by a specific plan may be more current.

In gathering this information, we have discovered that one of the inherent problems of conducting such an inventory is the incompleteness and lack of accuracy associated with multiemployer plan reporting. In many cases the 5500 or 5500B forms we used were incomplete, illegible or improperly filled in. Our concerns were further reinforced by a General Accounting Office (GAO) study which found similar problems. The Multiemployer Pension Plan Amendments Act of 1980 (MPPAA) required the General Accounting Office (GAO) to study the effects of the amendments and to coordinate its study with a number of Congressional Committees. Due to the need for accurate and complete data on multiemployer plans to effectively administer and enforce ERISA, GAO examined the adequacy of the data reported annually to the Internal Revenue Service (IRS) and the

Pension Benefit Guaranty Corporation (PBGC), the two agencies primarily responsible for administering and enforcing the amendments.

The GAO report (HRD-83-7, Oct. 25, 1982) found that (1) there is no assurance that all multiemployer plans are reporting as required and (2) when they do report, data is often missing or inaccurate. For example, PBGC's 1979 file of multiemployer plans showed a total of 64 percent more plans than the IRS's 1979 files for the same plans, according to GAO. Despite our best efforts it is important to keep in mind when reviewing these inventory results that many plans did provide incomplete data. This was particularly true in regards to the amount of vested benefits. Without this information it was impossible for us to calculate the unfunded vested liability (UVL) for many plans.

INTEREST RATE ASSUMPTIONS (576 Plans)

The AGC inventory includes information on the interest rate assumption that is utilized by the plans for funding purposes. Table I shows the breakdown of interest rate assumptions used by the plans. The average (mean) interest rate assumption of the plans contained in the inventory was 5.64 percent.

The median or the "middle" value was 5.47 percent. In other words, fifty percent of the plans had interest rate assumptions less than 5.47 percent, while fifty percent had values greater than the median.

Table I

Interest Rate Assumptions

Assumed Rate	Number of Plans	Assumed Rate	Number of Plans
Less than 4%	0	6.00%	211
4.0-4.99%	20	6.25%	7
5.00%	141	6.50%	22
5.25%	6	6.75%	6
5.50%	136	7.0-8.0%	16
5.75%	11	More than 8%	0
		TOTAL	576

NUMBER OF ACTIVE EMPLOYEES (573 Plans)

The size of the plans in our sample, as measured by active employees, varied widely with 78 percent of the plans falling within the range of 0-2,500 active employees (see Table II). The average number of active employees per plan was 944, while the median was 846. [These calculations do not include the two large Teamsters plans (Western Conference and Central States).]

Table II

Number of Active Employees	
0-500	205
501-1,000	118
1,001-2,500	134
2,501-5,000	76
5,001-10,000	18
More than 10,000	22
TOTAL	573

UNFUNDED VESTED LIABILITY (UVL) (419 Plans)

Attachment A represents individual plan data on plan assets, unfunded vested liability (UVL), the ratio of plan assets to vested benefits, and yearly contributions. An analysis of the level of UVL maintained by each plan reveals a wide swing with a high of $3.57 billion to no UVL and all variations in between. Of 419 plans providing information on the level of UVL, a surprising 204 or 48.7 percent had no UVL. This still leaves 51.3 percent of survey plans with UVL and, in many cases, potentially large employer withdrawal liability. It should be noted, however, that much of the UVL data is for 1978 or 1979. Since that time, management trustees have become more active in plan administration and many plans have gone to great lengths to improve funding. This effort should increase the number of plans that are well-funded.

VESTED BENEFITS FUNDING RATIO (Plan Assets/Vested Benefits)

A more useful indicator than just actual dollar size of UVL is a comparison of plan assets-to-vested benefits often referred to as the vested benefits funding ratio. Table III provides a comparison of the vested benefits funding ratios for the 419 plans that provided the necessary information to calculate the ratio. An analysis of our sample indicates that 49.4 percent of the plans had a vested benefit funding ratio of .9 or greater. In other words, 49.4 percent of the plans had assets equaling at least 90 percent of the plan's vested benefits (including the 48.7 percent of plans that had no UVL at all). At the other end of the scale, only 10 percent of the plans had a vested benefits funding ratio of .5 or less.

Table III

Vested Benefits Funding Ratio (Assets/Vested Benefits)	
0.9 or more	49.4%
less than 0.9 but not less than 0.7	22.7%
less than 0.7 but not less than 0.5	17.97%
less than 0.5	10.0%

These numbers are important given that AGC and other employer groups have concentrated their efforts for legislative reform of multiemployer ERISA on the need to require better plan funding. Specifically, the proposal AGC supports prevents plans from increasing benefits applicable to past service or granting past service credit unless the plan is well-funded. The AGC supported proposal would specifically permit such benefit increases only if the vested benefits funding ratio is at least .7 or greater during the first four plan years after enactment, and at least .9 or greater in all subsequent years.

Based upon the information that has been extracted from the inventory sample, the AGC-supported legislation would prevent only 28 percent of the plans in the inventory from adopting past service benefit increases until their assets-to-vested benefits ratio reaches at least 0.7.

The level of plan funding would also impact premiums payable to the Pension Benefit Guaranty Corporation (PBGC) under the proposed legislation. Under the current PBGC insurance system, multiemployer plans are required to pay a single per-participant premium annually ($1.40) regardless of the plan's funding status or risk to PBGC. The AGC-supported proposal would vary the "basic PBGC premium rate" (set at $1.40) so that plans with a lower vested benefits funding ratio (i.e., more poorly funded) would pay a higher premium while those that have a better assets-to-vested benefits ratio (i.e., plans that are well-funded) would pay a premium less than the basic premium rate.

By utilizing our sample information, we can illustrate how a system of risk-related premiums would apply utilizing the basic PBGC premium rate of $1.40 and the fact that the average number of active employees per plan was 944 participants. With this information and a schedule providing the risk factor of the plans based upon the vested benefits funding ratio, we can develop a breakdown of the premiums payable to PBGC.

As you can see from Table IV on the next page, implementation of the proposed risk-related premium would increase the total premiums payable to PBGC by the plans in the inventory sample by 11.7%, compared to the premiums payable today. At the same time, the average premium payable by each well-funded plan (i.e., each plan with a vested benefit funding ratio of .9 or greater) would decrease by 65% (from $1,321.60 annually to $859.04). Thus, such a risk-related system would serve to encourage plans to become well-funded, while providing PBGC with a larger amount of premiums payable to the system, based upon the risk that each plan poses to the insurance system as a whole.

RISK-RELATED PREMIUMS

Vested Benefits Funding Ratio	% of Plans	Current PBGC Premiums	Average Premium Paid Per Plan	Total Premiums Payable to PBGC	AGC Supported Variable Premiums	Premium Paid Per Plan	Total Premiums Payable to PBGC
0.9 or more	49.6%	$1.40	$1,361.60	$273,571.20	$ .91	$ 859.04	$177,821.28
less than 0.9, not less than 0.7	22.7%	$1.40	$1,321.60	$125,552.00	$1.40	$1,321.60	$125,552.00
less than 0.7 not less than 0.5	17.9%	$1.40	$1,321.60	$ 99,120.00	$2.10	$1,982.40	$148,680.00
less than 0.5	10.0%	$1.40	$1,321.60	$ 55,507.20	$4.20	$3,964.80	$166,521.60
			Total:	$553,750.40		Total:	$618,574.88

Related Analyses

Table V represents a craft by craft analysis of the ratio of plan assets-to-vested benefits based upon a percentage of plans reporting for each craft. On a craft by craft basis, the Carpenters' multiemployer plans appear to have the highest percentage of plans that are well funded (60.3%), while the Ironworkers have the lowest percentage of well funded plans (28.1%). At the other end of the scale, it appears that the crafts reporting the highest percentage of plans with assets-to-vested benefits ratio of less than .5 are maintained on behalf of the Laborers and Teamsters. It is also interesting to note that a substantial percentage of Ironworkers plans (34.3%) fall within the ratio of .5 to .69, indicating a need for improved funding.

Table V

CRAFT BY CRAFT ANALYSIS

Ratio of Plan Assets/Vested Benefits Craft	Less than .50	Less Than 0.7, Not Less Than 0.5	Less Than 0.9, Not Less Than 0.7	0.9 or more Less Than 1.0
Carpenters (73)	6.8%*	17.8	15.1	60.3
Operating Engineers (21)	9.5	14.3	4.8	71.5
Laborers (45)	11.1	17.8	15.6	55.6
Iron Workers (32)	6.3	34.3	31.3	28.1
Bricklayers (37)	5.4	16.2	13.5	64.8
Cement Masons (37)	2.7	13.5	27.0	56.8
Teamsters (19)	15.8	31.6	21.1	31.6

* Percentage of plans reporting

Table VI provides a region by region analysis of the ratio of plan assets-to-vested benefits. It should be noted that in some instances, the figures for a region may be somewhat misleading due to the fact that certain plans may be much larger than others. An analysis of Table VI indicates that both the Great Lakes and the South West Regions have the highest percentage of well-funded plans (i.e., with vested benefits funding ratio closer to 1). It is interesting to note that the Northeast Region has the lowest percentage of plans with a vested benefits funding ratio of .9 or more (22.2%), as well as having the highest percentage of poorly funded plans (22.2%) having a ratio of less than .5.

Table VI

Region by Region Analysis

Vested Benefits Funding Ratio	Northeast	Mid-Atlantic	South Eastern	Great Lakes	Mid-West	South West	Western
0.9 or more	22.2%*	35.3%	40.0%	68.3%	56.0%	68.8%	47.9%
less than 0.9, not less than 0.7	22.2%	21.6%	37.1%	19.2%	24.0%	12.5%	19.7%
less than 0.7, not less than 0.5	33.3%	32.8%	17.1%	7.7%	12.0%	9.4	19.7%
less than 0.5	22.2%	10.3%	5.7%	4.8%	8.0%	9.4%	12.7%
Total # of Plans	(18)	(116)	(35)	(104)	(25)	(32)	(71)

*percentage of plans reporting

Conclusion

There are few definite conclusions that can be drawn in the aggregate from AGC's pension plan inventory effort excepting that the funding levels of plans vary widely without any apparent pattern. There can be no doubt, although more plans are better funded than we first expected, that unfunded vested liability and potential employer withdrawal liability are still a serious problem for our industry. Contractors involved with plans which are less well-funded should work to improve funding either at the bargaining table or through the plan trustees. Various options are available including an agreement to divert a portion of plan contributions to reduce UVL or an agreement to cap benefits until funding reaches a certain level. Contractors involved with well-funded or fully-funded plans should consider trust or collective bargaining agreement language perventing any slippage in the funding level. Conversion to a defined-contribution plan should also be reviewed. Defined-contribution plans specifically limit an employer's liability to his agreed-to per hour contributions and also provide significant advantages to construction workers in regards to portability and vesting.

February 1983

Dan Knise
Steve Lindauer

INVENTORY OF PENSION STATUS BY REGION

Attachment A

(February 1983)

Region, State and Plan	Total Plan Assets (millions)	Level of UVB (millions)	[illegible]	Total [illegible] Contributions (millions)
NORTH EAST REGION				
Connecticut				
Asbestos Workers (1979)	$ 1.84	$ 2.[illegible]	.41	$.[illegible]
Conn. State Carpenters (1980)	$ 41.7[illegible]	-0-	[illegible]	$ 1.[illegible]
IBEW #90 (1978)	$ 7.01	---	---	$ .4[illegible]
Ironworkers #[illegible] (1977)	$ 14.72	---	---	$ 2.[illegible]
Ironworkers #15 & #424 (1980)	$ 22.50	$ 2.[illegible]	.[illegible]	$ [illegible]
IUOE #478 (1980)	$ 15.44	---	---	$ [illegible]
Plumbers #76 (1978)	$ 2.45	$ 1.[illegible]	[illegible]	$ .25
Conn. Plumbers & Pipefitters (19[illegible])	$ 16.20	$ 11.[illegible]	[illegible]	$ 1.84
Roofers #9 (1979)	$ 2.[illegible]	---	---	$ .29
Sheet Metal Workers #40 (1978)	---	---	---	$ .14
Steamfitters #218 (1978)	$ 4.[illegible]	$ 1.12	.78	$ .41
Massachusetts				
Asbestos Workers (1979)	$ 3.[illegible]	$ 2.13	.43	$ .4[illegible]
Bricklayers #[illegible] (1977)	$ .82	$.[illegible]	.[illegible]	$ .11
Bricklayers, Masons, Plasterers #[illegible] (1978)	$ 1.1[illegible]	---	---	$ .11
Bricklayers & Masons #[illegible] (1978)	$ [illegible]	---	---	$ .75
Bricklayers #6	$ 1.15	$.[illegible]	.6[illegible]	$ .1[illegible]
Springfield Carpenters (1980)	---	$ 2.[illegible]	[illegible]	$.[illegible]
Western Mass. Carpenters (1978)	---	---	---	$ .04
Cement Masons & Asphalt Layers #534 (1977)	$ 1.[illegible]	---	---	$ .04
North Shore Masons (1978)	$ 1.0[illegible]	---	---	$ .0[illegible]
IBEW #7 (1976)	$ 1.01	---	---	$ .85
IBEW #223 (1978)	$ 1.50	-0-	1.[illegible]	$.[illegible]
Ironworkers Distr. Council of New England (1978)	$ 19.98	$ 27.51	.4[illegible]	$ 1.67
Northeast Ironworkers (19[illegible])	---	$ 24.57	---	$ 1.2[illegible]
Massachusetts Laborers (19[illegible])	$ 61.15	$ 37.67	.62	$ 12.96
Operating Engineers #4 (19[illegible])	---	$ 34.69	---	$ [illegible]
Operating Engineers #98 (19[illegible])	---	$ 2.68	---	$ [illegible]
Painters Distr. Council #35 (1979)	$ [illegible]	$ 8.18	.[illegible]	$ 1.[illegible]
Northampton Plumbers & Steamfitters #64 (1978)	$ .98	---	---	$ .78
Plumbers Union #89 (1978)	$ 1.14	---	---	$ [illegible]
Plumbers & Pipefitters #276 (1977)	$ 1.61	---	---	$ [illegible]
Sheet Metal Workers #63 (1978)	$ 1.[illegible]	$ 1.41	.[illegible]	$ .1[illegible]
New Hampshire				
Carpenters - Northern New Engl. (1978)	$ 4.[illegible]	$ 4.[illegible]	.[illegible]	$ 1.[illegible]
Plumbers & Steamfitters #131 (1981)	$ 1.98	$.[illegible]	.7[illegible]	$.[illegible]
Rhode Island				
Bricklayers - Rhode Island (1978)	$ 2.58	---	---	$ .12
Laborers - Rhode Island (1978)	$ 7.81	$ 7.[illegible]	.[illegible]	$ 1.66
Operating Engineers #57 (1979)	---	---	---	$ 1.[illegible]
Sheet Metal Workers #17 (1977)	$ .86	---	---	$ .29
Vermont				
Vt. State Conference of Bricklayers, Masons, and Plasterers (1980)	$ .75	-0-	1.[illegible]	$ .01
MID-ATLANTIC REGION				
Delaware				
Bricklayers #1 (1980)	$ 2.32	-0-	1.[illegible]	$ .21
Laborers #199 and #847 (1980)	$ .56	$ .96	.37	$ .98

Region, State and Plan	Total Plan Assets (millions)	Level of UVL (millions)	Ratio of Plan Assets/Vested Benefits	Total Yearly Contributions (millions)
Delaware cont.				
Carpenters #626 (1978)	$ 5.38	---	---	$ .78
IBEW #313 (1980)	$ 5.87	-0-	1.0	$ 1.03
District of Columbia				
IBEW	---	$ 290.00	---	$ 33.25
Carpenters	---	---	---	$ 4.14
Cement Masons (1978)	$ 1.60	$ .76	.68	$ .29
Iron Workers (1977)	$ 25.03	$ 19.74	.56	$ 6.33
Laborers - District Council (1979)	$ 19.06	$ 3.35	.85	$ 1.80
Painters & Allied Trades (1980)	$ 146.04	$ 197.18	.43	$ 36.85
Plumbers & Pipefitters (1978)	$ 5.26	$ 6.76	.44	$ 1.26
Sheet Metal Workers (1978)	$ 369.98	-0-	1.0	$ 39.74
Operating Engineers (1979)	$ 13.22	---	---	$ .88
Teamsters #639 (1979)	$ 19.71	---	---	$ 4.50
Maryland				
Asbestos Workers #4. (1978)	$ 2.31	---	---	$ .25
Bricklayers #6 (1977)	$ 1.24	---	---	$ .34
Bldg. & Constr. Employees Cumberland, MD & Vicinity	$ 1.33	---	---	$ .19
Ironworkers - Laborers Pension Fund (1979)	$ 4.21	-0-	1.0	$ .83
Operating Engineers #37	$ 12.90	---	---	$ 2.94
Operating Engineers - Wash., D. C.	---	---	---	$ 1.82
Plumbers & Gasfitters #48 (1978)	$ 1.91	$ 2.89	.4	$ .47
Teamsters #355	$ 10.06	$ 5.47	.65	$ 2.17
New Jersey				
Bricklayers, Masons & Plasterers - Passaic County (1976)	$ 1.71	---	---	$ .19
Bricklayers, Masons & Plasterers #21 (1979)	$ .87	$ .29	.75	$ .13
Bricklayers #6 (1976)	$ 2.01	---	---	$ .25
Bricklayers - Central Union Cty. (1973)	$ 1.12	$ .19	.85	$ .97
Bricklayers - Middlesex (1976)	$ 1.86	$ .11	.94	$ .30
New Jersey Carpenters (1979)	$ 47.95	-0-	1.0	$ 8.19
Carpenters Resilent Flooring (1978)	$ 1.94	$ .86	.69	$ .20
Carpenters #31 (1977)	$ 1.90	---	---	$ .50
Hudson City Carpenters (1977)	$ 3.10	$ 4.33	.42	$ .51
IBEW #52 (1978)	$ 8.67	$ 1.11	.89	$ 1.03
IBEW #102 (1979)	$ 2.85	$ .17	.94	$ .33
IBEW #164 (1977)	$ 10.77	$ .53	.95	$ .65
IBEW #211 (1978)	$ .77	$ .12	.87	$ .26
IBEW #262 (1976)	$ 1.60	-0-	1.0	$ .23
IBEW #269 (1976)	$ 1.03	$ .83	.79	$ .25
IBEW #358 (1976)	$ 1.98	$ 1.07	.65	$ .30
IBEW #456 (1976)	$ 2.37	$ .57	.81	$ .26
IBEW #581 (1979)	$ 3.53	$ .70	.83	$ .45
IBEW #592 (1976)	$ 2.51	-0-	1.0	$ 1.21
IBEW #1158 (1978)	$ .87	---	---	$ .30
Laborers #156 (1978)	$ 1.62	$ .95	.63	$ .35
Laborers #369 (1978)	$ 1.50	---	---	$ .19
Laborers #415 (1979)	$ 1.36	---	---	$ .32
Laborers #734 (1978)	$ 6.78	-0-	1.0	$ 1.01
Laborers #779 (1976)	$ .98	$ .06	.94	$ .14
Laborers Distr. Council - Hudson Cty. (1976)	$ 2.26	$ .17	.93	$ .44
Laborers - Union County (1979)	$ 4.93	$ 3.11	.61	$ .91
Newark Laborers (1978)	$ 1.92	$ 1.95	.49	$ .50
Laborers - Bergen County (1976)	$ 5.51	-0-	1.0	$ .55
Laborers #222 (1979)	$ 6.10	$ .23	.96	$ 1.19
Laborers #472 & #172	$ 99.82	-0-	1.0	$ 6.43

February 1983

Region, State and Plan	Total Plan Assets (millions)	Level of UVL (millions)	Ratio of Plan Assets/Vested Benefits	Total Yearly Contributions (millions)
New Jersey cont.				
No. N.J. Ironworkers (1979)	$ 92.60	$ .61	.99	---
Philadelphia Ironworkers (1979)	$ 72.37	$ 15.67	.82	$ 8.16
Operating Engineers #825 (1980)	$ 102.59	$ 58.88	.64	$ 10.00
Plumbers Union #14	$ 1.45	---	---	$ .39
Plumbing & Pipefitters #274 (1979)	$ 5.46	---	---	$ .83
Plumbing & Pipefitters #322 (1978)	$ 6.41	---	---	$ 1.38
Plumbers & Pipefitters #24 (1978)	$ 3.95	---	---	$ .75
Plumbers - Refrig. & Air Cond. (1977)	$ 1.81	-0-	1.0	$ .38
Sheet Metal Workers #10 (1978)	$ 5.36	$ 2.25	.7	$ .70
Teamsters #408 (1980)	$ 11.18	-0-	1.0	---
Teamsters #469 (1980)	$ 19.83	-0-	1.0	$ 2.87
Teamsters #815 (1976)	$ 32.48	---	---	$ 4.63
New York				
Asbestos Workers #4 (1977)	---	---	---	$ .19
Asbestos Workers #91 (1976)	$ 1.33	---	---	$ .1
Blasters, Drillrunners & Miners #29 (1979)	$ 4.50	$ 2.03	.69	$ .94
Boilermakers #5 (1979)	$ 5.90	---	---	$ .27
Bricklayers #28 (1979)	$ 1.17	$ 1.55	.43	$ .17
Bricklayers #29 (1978)	$ 1.17	---	---	$ .41
Bricklayers #45 (1980)	$ 6.84	-0-	1.0	$ .92
Geneva Bricklayers #43 (1979)	$ .46	$ .30	.61	$ .06
No. N.Y. Bricklayers and Masons (1979)	$ 1.01	---	---	$ .12
Owego Bricklayers #54 (1979)	$ .35	-0-	1.0	$ .05
Carpenters #66 (1978)	$ 5.25	$ 2.51	.68	$ .54
Carpenters #280 - Niagara, Genesee, & Vicinity (1979)	$ 4.27	$ 3.38	.56	$ .80
Carpenters #3127 (1978)	$ 4.06	-0-	1.0	$ .64
Carpenters - Finger Lakes Distr. Council (1978)	$ 4.53	$ 3.63	.56	$ .64
N.Y.C. Distr. Council of Carp. (1979)	$ 139.15	$ 42.87	.76	$ 16.30
Carpenters - Nassau County (1978)	$ 15.33	$ 3.00	.84	$ 1.71
Carpenters - Suffolk County (1979)	$ 21.09	---	---	$ 1.31
Buffalo Carpenters (1980)	$ 21.41	$ 16.06	.57	$ 2.95
Onondaga Carpenters (1979)	$ 7.89	$ 1.87	.81	$ .90
Rochester Carpenters (1980)	$ 9.59	$ 4.38	.69	$ 1.26
Cement Masons #519 (1979)	$ .52	$ .36	.59	$ .08
Buffalo Cemen* Masons #511 (1980)	$ 2.29	---	---	$ .34
Masons Tenders Distr. Council (1979)	$ 46.21	---	---	$ 2.93
Concrete Workers - Distr. Council (1978)	$ 36.25	$ 3.03	.92	$ 2.50
Construction Workers #147 (1978)	$ 6.74	$ .20	.97	$ .69
IBEW #25 (1976)	$ 15.21	$ 3.67	.81	$ 1.16
IBEW #43	---	---	---	$ .23
IBEW #6 (1979)	$ 4.10	-0-	1.0	$ .31
IBEW #139 (1977)	$ 1.18	---	---	$ .03
IBEW #215 (1978)	---	---	---	$ .07
IBEW #328 (1978)	$ 1.55	$ .75	.67	$ .43
IBEW #363 (1978)	$ 4.72	---	---	$ .19
IBEW #501 (1977)	$ 18.80	---	---	$ 1.10
Albany Electrial Workers #724 (1978)	$ 3.85	---	---	$ .23
Engineers #545 (1980)	$ 52.62	$ 30.10	.58	$ 7.20
Glaziers #1087 (1977)	$ 6.20	-0-	1.0	$ .28
Hod Carriers #210 (1978)	$ 21.60	$ 14.62	.6	$ 2.84
W. N.Y. Ironworkers (1980)	$ 16.62	$ 12.40	.57	$ 2.30
Niagara Frontier Ironworkers #6 (1980)	$ 10.63	$ 7.74	.58	$ 1.77
Ironworkers #40, #361 & #417 (1978)	$ 19.27	$ 15.63	.55	$ 1.54

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Region, State and Plan	Total Plan Assets (millions)	Level of UVL (millions)	Ratio of Plan Assets/Vested Benefits	Total Yearly Contributions (millions)
New York cont.				
Iron Workers #580 (1978)	$ 13.56	$ 5.81	.7	$ .75
Onondaga Laborers (1979)	$ 5.81	$ 3.30	.64	$ .79
Rochester Laborers (1980)	$ 15.59	$ 7.32	.67	$ 1.69
Laborers #60 - Westchester Heavy Construction (1977)	$ 9.19	$ 2.37	.79	$ 1.07
Laborers #91 (1977)	$ 5.19	---	---	$ .78
Laborers #102 (1979)	$ 3.19	$ .21	.94	$ .44
Laborers #103 (1977)	$ 2.23	---	---	$ .31
Constr. & Common Laborers #159 (1980)	$ 7.91	$ .13	.98	$ .81
Oswego Laborers #214 (1975)	$ 5.22	-0-	1.0	$ .78
Laborers #322 (1980)	$ 6.13	$ .50	.92	$ .47
Laborers #589 (1979)	$ 1.33	---	---	$ .18
Laborers #754 (1978)	$ 3.26	$ .40	.89	$ .34
Laborers #1298 (1978)	$ 26.91	$ 6.98	.79	$ 1.73
Westchester & Putnam Counties Building Laborers' Pension Fund (1979)	$ 7.58	$ 6.63	.53	$ 1.42
Marble Industry Employees Assn. (1978)	$ 2.31	---	---	$ .20
Metal Trades Branch #638 (1977)	$ 13.05	---	---	$ 1.46
Operating Engineers #14, #14B, #15, #15A, #15C & #15D (1979)	$ 7.55	---	---	$ 1.94
Upstate Operating Engineers #17, #106, #410, #463, #545 & #832 (1980)	$ 60.97	$ 35.11	.63	$ 6.86
Operating Engineers #137, #137A, #137B, #137C, #137R (1978)	$ 19.82	---	---	$ 1.57
Operating Engineers #295 & #295C (1978)	$ 1.63	---	---	$ .28
Painters - Westchester & Putnam Counties (1978)	$ 1.90	---	---	$ .21
Central NY Painters (1978)	$ 1.05	$ .11	.91	$ .23
Pointers, Cleaners, Caulkers #66 (1979)	$ 2.52	$ .41	.86	$ .52
Pavers & Roadbuilders - Distr. Council (1979)	$ 9.81	$ 2.92	.77	$ 1.37
Plasterers #51 (1979)	$ .20	$ .03	.87	$ .03
Plastering Industry #60 (1977)	$ 2.03	$ 1.90	.52	$ .18
Plumbers #1 (1979)	$ 4.77	$ 20.79	.18	$ 2.36
Plumbers & Pipefitters #79 (1978)	$ 2.13	---	---	$ .35
Plumbers & Pipefitters #109 (1978)	$ 2.65	$ 1.43	.65	$ .19
Plumbers & Pipefitters #269 (1978)	$ 1.48	$ .86	.63	$ .16
Plumbers & Pipefitters #273 (1980)	$ 3.34	---	---	$ .90
Plumbers #371 (1979)	$ 2.68	$ .58	.82	$ .40
Plumbers #457 (1978)	$ 4.36	$ 5.24	.45	$ .60
Plumbers #773 (1976)	$ 3.80	---	---	$ .47
Plumbers & Steamfitters #7 (1979)	$ 5.72	---	---	$ .86
Plumbers & Steamfitters, UA #13 (1977)	$ 6.45	$ 2.34	.73	$ .98
Plumbers & Steamfitters #105 (1978)	$ 2.98	---	---	$ .82
Steamfitters #543 (1979)	$ 12.55	---	---	$ 1.42
Steamfitters - Ind. Pension Fund (1978)	$ 38.00	$ 3.31	.92	$ 6.19
Roofers & Waterproofers (1978)	$ 2.51	---	---	$ .53
Roofers #22 (1977)	$ 1.08	---	---	---
Roofers #74 (1978)	$ 4.94	---	---	$ .65
Sheet Metal Workers #46 (1979)	$ 4.86	$ .49	.91	$ .58
Sheet Metal Workers #55 (1979)	$ 9.51	$ 7.63	.55	$ 1.02
Sheet Metal Workers #112 - Southern Tier (1980)	$ 3.29	---	---	$ .32
Sheet Metal Workers #137 (1978)	$ 4.29	---	---	$ .33
Teamsters #27 (1978)	$ 24.99	---	---	$ 2.19
Teamsters #283 (1978)	$ 58.19	$ 78.71	.43	$ 7.24
Teamsters #445 - Constr. (1978)	$ 9.11	---	---	$ .63
Teamsters #804 (1978)	$ 1.00	-0-	1.0	$ .03
Teamsters #814 (1978)	$ 19.32	$ 22.46	.46	$ 3.02
Teamsters #816 (1978)	$ 23.53	$ 42.17	.36	$ 3.19
Teamsters #851 (1978)	$ 20.46	---	---	$ 2.94

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Region, State and Plan	Total Plan Assets (millions)	Level of UVL (millions)	Ratio of Plan Assets/Vested Benefits	Total Yearly Contributions (millions)
New York cont.				
Teamsters #868 (1977)	$ .99	---	---	$ .15
Teamsters - NY State Conf. (1978)	$ 151.57	---	---	$ 23.88
Teamsters - Westchester (1978)	$ 25.68	---	---	$ 1.93
Pennsylvania				
Asbestos Workers - Phila. (1978)	$ 5.65	---	---	$ .82
Bricklayers 4 combined funds (1980)	$ 1.26	$ .03	.98	$ .12
Bricklayers #8 & Plasterers #233 (1977)	$ 1.05	---	---	$ .07
Brick & Clay Workers #12 (1978)	$ 1.38	$ 1.38	.5	$ .23
Bricklayers #15 (1978)	$ .77	---	---	$ .08
Bricklayers #19 (1980)	$ .54	$ .44	.55	$ .05
Bricklayers #47 (1980)	$ .58	-0-	1.0	$ .06
Bricklayers #64 (1979)	$ 1.76	---	---	$ .16
Bricklayers #71 (1977)	$ .93	---	---	$ .14
Carpenters #191 (1980)	$ 1.34	$ 1.29	.51	$ .25
Carpenters #492 (1978)	$ 1.03	---	---	$ .24
Keystone Carpenters (1980)	$ 6.21	---	---	$ .91
Carpenters - Lehigh Valley (1979)	$ 5.34	---	---	$ .58
Carpenters - Phila. Vicinity (1979)	$ 68.70	---	---	$ 9.27
IBEW #143 (1976)	$ 2.50	-0-	1.0	$ .46
IBEW #380 (1978)	$ 1.12	---	---	$ .33
IBEW #609 (1979)	$ 7.03	-0-	1.0	$ .03
IBEW #703 (1979)	$ .70	-0-	1.0	$ .27
IBEW #654 (1976)	$ 1.11	---	---	$ .34
PA Heavy & Highway Constr. (1978)	$ 8.66	$ .03	.99	$ 1.17
Ironworkers #348	---	---	---	$ .50
Ironworkers #502 (1979)	$ 4.51	$ 4.52	.5	$ .84
Ironworkers - Phila. (1977)	$ 55.24	$ 42.32	.57	$ 7.03
Laborers #708 & #1180 (1980)	$ 3.64	$ 1.58	.7	$ .43
Plasterers and Masons #94, #367 & #480 (1980)	$ .46	$ .21	.69	$ .08
Plumbers & Pipefitters #520 (1979)	$ 9.02	---	---	$ 1.27
Plumbers #690 (1978)	$ 1.64	---	---	$ .19
Steamfitters #420 (1979)	$ 31.71	---	---	$ 6.05
Sheet Metal Workers South East Phila. (1978)	$ 21.38	---	---	$ 3.44
Teamsters - Phila. (1979)	$ 98.18	---	---	$ 25.23
Teamsters - Central PA (1979)	$ 182.12	$ 146.44	.55	$ 31.53
Virginia				
Bricklayers & Stone Masons #2	---	---	---	$ .06
Ironworkers #79 (1978)	$ 2.56	$ .66	.8	$ .32
Teamsters - Richmond (1979)	$ 4.12	$ 2.40	.63	$ .42
West Virginia				
Ironworkers #549 & #550 (1978)	$ 7.32	---	---	$ 1.42
W. Virginia Laborers (1978)	$ 12.07	---	---	$ 2.92
Operating Engineers #132 (1977)	$ 14.58	---	---	$ 2.04
Plumbers & Steamfitters #[illegible]90 (1979)	$ 3.27	$ 2.37	.58	$ .44
Plumbers & Steamfitters (1977)	$ 1.35	---	---	$ .54
Plumbers & Steamfitters - Wheeling (1978)	$ 2.58	---	---	$ .59
SOUTHEAST REGION				
Alabama				
Asbestos Workers #55 (1978)	$ 2.41	$ .57	.81	$ .40
AGC-Building Trades (1978)	$ 14.74	$ 6.05	.71	$ 1.54
AFL-AGC Pension Fund (1980)	$ 20.81	$ .19	.99	$ 1.50
Jefferson Co. Carpenters (1980)	$ 3.39	-0-	1.0	$ .47

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Region, State and Plan	Total Plan Assets (millions)	Level of UVL (millions)	Ratio of Plan Assets/Vested Benefits	Total Yearly Contributions (millions)
Alabama cont.				
Birmingham Ironworkers #92 (1980)	8.11	$ 2.94	.73	$ .88
Plumbers & Steamfitters #52 (1978)	$ 2.50	---	---	$ .45
Plumbers #91 - Birmingham (1978)	$ 3.85	$ 1.49	.72	$ .82
Sheet Metal Workers #48 (1979)	$ 3.04	$ 4.20	.42	$ .56
Florida				
Bricklayers #15 & #11 (1978)	$ .78	-0-	1.0	$ .03
So. Fla. Carpenters (1979)	$ 20.01	$ 4.66	.81	$ 2.23
Carpenters - Jacksonville & Vic. (1977)	$ 4.94	$ 1.88	.72	$ .53
Carpenters - Palm Beach Co. (1976)	$ 4.31	-0-	1.0	$ .47
IBEW #177	---	---	---	$ .51
Miami Ironworkers #272 (1979)	$ 3.73	$ 2.33	.62	$ .46
Ironworkers #597 (1977)	$ 2.25	$ 1.81	.55	$ .27
Ironworkers #808 - Central Fla. (1977)	$ 1.57	$ .29	.84	$ .21
Fla. Marble Polishers #121 (1977)	$ 1.44	-0-	1.0	$ .12
Operating Engineers #487 (1979)	$ 11.00	-0-	1.0	$ .84
Operating Engineers #675 (1978)	$ 17.10	---	---	$ 1.30
Jacksonville Plumbers #234 (1978)	$ 5.60	$ .81	.87	$ .66
Plumbers & Fitters #295 (1977)	$ 2.87	$ .84	.77	$ .28
Plumbers #519 (1978)	$ 6.17	$ 2.29	.73	$ .47
Plumbers & Pipefitters #624 (1978)	$ 6.21	$ 1.84	.7	$ .04
Plumbers & Pipefitters #719 (1977)	$ 4.01	-0-	1.0	$ .20
Steamfitters #725 (1977)	$ 11.46	$ 5.97	.66	$ 1.30
Dade Co. Trowel Trades (1979)	$ 5.04	$ 3.18	.61	$ .57
Wood, Wire and Metal Lathers #345 (1979)	$ .11	$ .26	[illegible]	$ .04
Georgia				
Carpenters - Atlanta & Vic. (1979)	$ 13.10	-0-	1.0	$ 1.75
Elberton Granite Workers (1977)	$ 1.38	$ .52	.73	$ .29
Plasterers #148 (1978)	$ 1.31	---	---	$ .32
North Carolina				
Plumbers & Pipefitters (1977)	$ 2.04	-0-	1.0	$ .55
Plumbers & Pipefitters - NC (1976)	$ 6.97	-0-	1.0	$ 1.83
Tennessee				
Carpenters #345 (1980)	$ 3.23	$ 1.71	.65	$ .52
Middle Tenn. Carpenters (1980)	$ .88	$ .11	.89	$ .09
Tri-State Carpenters and Joiners of Chattanooga (1980)	$ 24.58	-0-	1.0	$ 4.47
IBEW - Memphis (1978)	$ 3.85	$ 2.19	.64	$ .70
Ironworkers #167 (1978)	$ 2.34	---	---	---
Tenn. Valley Ironworkers (1980)	$ 15.11	-0-	1.0	$ 4.05
Plumbers #102 (1980)	---	---	---	$ .73
Plumbers & Pipefitters #572 (1979)	$ 6.57	---	---	$ 1.42
Plumbers & Steamfitters #43 (1978)	$ 4.86	-0-	1.0	$ 1.51
Sheet Metal Workers #4 (1979)	$ 1.21	-0-	1.0	$ .11
Sheet Metal #177 (1977)	$ .73	---	---	$ .10
GREAT LAKES REGION				
Illinois				
Asbestos Workers (1980)	$ 12.99	$ 11.00	.54	$ 2.38
Bricklayers #3 & #18 (1979)	$ 3.31	---	---	$ .43
Bricklayers #20 (1980)	$ 3.87	$ .17	.96	$ .50
Bricklayers #71 (1979)	$ 27.38	---	---	$ 3.05
Chicago Bricklayers (1979)	---	---	---	$ 3.05

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Region, State and Plan	Total Plan Assets (millions)	Level of UVL (millions)	Ratio of Plan Assets/Vested Benefits	Total Yearly Contributions (millions)
Illinois cont.				
Carpenters #644 (1980)	$ 2.99	$ .69	.81	$ .43
Carpenters - Chic. Distr. Council (1979)	$ 150.73	$ 177.40	.46	$ 28.13
Carpenters of Illinois (1979)	$ 54.52	-0-	---	$ 11.91
Chicago Carpenters (1979)	$ 124.03	$ 177.41	.41	$ 28.13
Danville Carpenters (1980)	$ .58	$ .07	.89	---
Tri-Counties Carpenters (1980)	$ 13.39	-0-	1.0	$ 1.48
Plasterers & Cement Masons #12 (1979)	$ 1.74	$ .72	.71	$ .26
Cement Masons #90 (1980)	$ 1.20	-0-	1.0	$ .16
Central Cement Masons and Plasterers (1980)	$ .61	-0-	1.0	$ .06
Chicago Cement Masons (1979)	$ 11.85	$ 3.68	.76	$ 2.39
IBEW #9 (1979)	$ 5.09	---	---	$ .40
IBEW #117 (1979)	$ 1.70	---	---	$ .38
IBEW #145 (1978)	$ 3.26	-0-	1.0	$ .58
IBEW #150 (1979)	$ 5.41	-0-	1.0	$ 1.07
IBEW #346 (1978)	$ 2.38	---	---	$ .74
IBEW #701 (1978)	$ 6.61	---	---	$ 1.16
IBEW (1979)	$ 20.78	---	---	$ 41.21
Excavators & Pavers #731 (1980)	$ 15.69	$ 7.56	.67	$ 3.36
Glazier Union #27	$ 2.56	$ 5.26	.33	$ .57
Iron Workers (1980)	$ 78.20	-0-	1.0	$ 11.02
Structural Iron Workers #1 (1978)	$ 22.43	---	---	$ 2.30
Laborers Union Union Trust (1979)	$ 154.22	---	---	$ 28.42
Laborers #100 & #397 (1979)	$ 4.93	---	---	$ .76
Laborers #231 (1980)	---	-0-	1.0	---
Central Laborers (1979)	$ 58.09	-0-	1.0	$ 8.64
Chicago Laborers (1979)	$ 154.15	$ 16.07	.91	$ 26.10
United Assn. Tech. Engineers #130 (1979)	$ 2.24	-0-	1.0	$ .22
Midwest Operating Engineers #150 (1980)	$ 153.49	-0-	1.0	$ 21.56
Operating Engineers #520 (1980)	$ 10.67	$ .12	.99	$ 2.74
Painters #30 - Dupage Co. (1979)	$ 3.52	---	---	$ .57
Chicago Painters & Decorators (1979)	$ 25.28	$ 4.40	.85	$ 4.06
E. Central Illinois Pipe Trades (1979)	$ 6.87	---	---	$ .94
Chicago Plastering Inst. (1980)	$ 4.34	$ .67	.87	$ .58
Plumbers #93 (1979)	$ 3.55	$ .04	.99	$ .68
Plumbers #130 (1979)	$ 36.50	---	---	$ 4.68
Plumbers & Steamfitters #137 (1979)	$ 5.71	---	---	$ .49
Plumbers & Pipefitters Ind. #319 (1979)	$ 1.12	---	---	$ .12
Plumbers & Pipefitters #507 (1980)	$ 4.90	-0-	1.0	$ .64
Pipefitters #597 (1980)	$ 110.47	$ 29.43	.79	$ 13.75
Steamfitters #439 & Plumbers #360 (1978)	$ 3.62	---	---	$ .43
Sheet Metal Workers #73 (1979)	$ 51.17	---	---	$ 4.75
Sheet Metal Workers #230 (1980)	$ 1.30	---	---	$ .13
Sheet Metal Workers #265 (1978)	$ 3.19	---	---	$ .25
Teamsters #301 (1979)	$ 12.39	---	---	$ 2.10
Teamsters #705 (1979)	$ 154.35	$ 113.34	.57	$ 24.38
Teamsters #710	$ 226.44	$ 61.27	.79	$ 29.65
Ceramic Tile Contractors	$ 3.65	$ .87	.81	$ .38
Tuckpointers #52 (1979)	$ 1.93	$ .36	.92	$ .43
Wood, Wire & Metal Lathers #74 (1979)	$ 4.44	-0-	1.0	$ .28
Indiana				
Bricklayers #3 (1979)	$ 2.18	---	---	$ .18
Bricklayers #6 (1979)	$ 4.60	-0-	1.0	$ .55
Bricklayers #18 (1980)	$ 1.34	-0-	1.0	$ .15
Carpenters #215 (1980)	$ .89	-0-	1.0	$ .36
Carpenters #232 (1980)	$ 1.54	-0-	1.0	$ .42
Carpenters #413 (1980)	$ 5.44	-0-	1.0	$ .72
Central and Western Ind. Carpenters (1980)	$ 15.70	-0-	1.0	$ 2.13

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Region, State and Plan	Total Plan Assets (millions)	Level of UVL (millions)	Ratio of Plan Assets/Vested Benefits	Total Yearly Contributions (millions)
Indiana cont.				
Council of Carpenters (1980)	$ 9.59	-0-	1.0	$ 1.95
Evansville Carpenters (1980)	$ 2.27	-0-	1.0	$ .43
Fall Cities Carpenters (1980)	$ 11.75	-0-	1.0	$ 1.53
Wabash Valley Carpenters (1980)	$ .91	$ .33	.73	$ .26
Carpenters, IN State Council (1980)	$ 9.59	-0-	1.0	$ 1.90
Constr. Workers - Lake Co. & Vic. (1980)	$ 21.28	-0-	1.0	$ 2.71
Electrial Workers #481 (1979)	$ 8.92	---	---	$ .91
Laborers and Hod Carriers (1980)	$ 68.62	-0-	1.0	$ 7.71
Painting & Decorating Contractors #8 (1979)	$ .91	---	---	$ .19
Plumbers & Pipefitters #172 (1980)	$ 2.48	-0-	1.0	$ .35
Plumbers & Steamfitters #166 (1979)	$ 2.72	$ .43	.86	$ .30
Sheet Metal Workers #303 (1979)	$ 5.58	$ 1.61	.78	$ .07
Kentucky				
Bricklayers #1 & #14 (1979)	$ 2.16	-0-	1.0	$ .23
Carpenters - Lower Ohio Valley (1978)	$ 2.41	---	---	$ .82
Plumbers #107 (1978)	$ 4.72	---	---	$ .78
Plumbers & Steamfitters #248 (1977)	$ 3.47	---	---	$ .75
Sheet Metal Workers #10 (1978)	$ 7.30	$ 6.75	.52	$ 1.32
Sheet Workers - Highway Contr., Inc. (1979)	$ 4.99	-0-	1.0	$ .93
Michigan				
Asbestos Workers #25 (1978)	$ 3.41	---	---	$ .64
Bricklayers - Metro Area (1979)	$ 25.49	-0-	1.0	$ 2.30
Bricklayers - Saginaw Valley (1979)	$ 1.33	---	---	$ .18
Detroit Bricklayers (1980)	$ .34	-0-	1.0	$ 1.67
Detroit Carpenters (1980)	$ 152.91	-0-	1.0	$ 12.14
Michigan Carpenters (1980)	$ 48.15	-0-	1.0	$ 6.06
Detroit Cement Masons (1980)	$ 10.66	-0-	1.0	$ .96
IBEW #58 (1979)	$ 42.81	---	---	$ 6.13
IBEW #252 (1980)	$ 3.02	$ 2.99	.5	$ .50
Michigan Electrical Employees (1979)	$ 13.55	---	---	$ 3.23
Ironworkers #25 (1980)	$ 67.35	-0-	1.0	$ 8.57
Ironworkers #426 (1979)	$ 14.05	---	---	$ 1.05
Ironworkers - Western Mich.	$ 5.51	---	---	$ 1.35
Laborers #1075 (1978)	$ 1.85	---	---	$ .24
Detroit Laborers (1980)	$ 53.23	-0-	1.0	$ 4.75
Michigan Laborers (1980)	$ 44.78	-0-	1.0	$ 4.39
Operating Engineers #324 (1980)	$ 131.74	$ 11.22	.92	$ 20.71
Painters #1052 (1979)	$ .88	---	---	$ .07
Painters Union (1979)	$ 21.88	$ 15.05	.59	$ 3.45
Plasterers #67 (1979)	$ 1.99	---	---	$ .11
Plasterers Tenders Pension (1978)	$ .93	---	---	$ .10
Plumbers #98 & #636 (1979)	$ 33.21	$ 79.53	.29	$ 5.77
Plumbers & Steamfitters #335 (1979)	$ .91	$ .23	.81	$ .19
Plumbers, Steamfitters & Pipefitters #337 (1979)	$ 3.61	$ .26	.94	$ .61
Plumbers, Steamfitters & Pipefitters #388 (1979)	$ 4.09	---	---	$ 1.05
Plumbers & Pipefitters $513 (1979)	$ 1.56	---	---	$ .16
Plumbers & Pipefitters #816 (1979)	$ 1.65	-0-	1.0	$ .19
Plumbers & Pipefitters - Upper Peninsula (1979)	$ 3.04	---	---	$ .57
Resilient Floor Decorators #2265 (1979)	$ 5.69	---	---	$ .42
Sheet Metal Workers #292 (1977)	$ 7.55	---	---	$ 1.20
Sheet Metal Workers #360 (1979)	$ 4.91	---	---	$ 1.10
Sheet Metal Workers #408 (1979)	$ 4.59	---	---	$ .58
Sheet Metal Workers #583 (1979)	$ 4.74	$ 1.66	.74	$ .62
Outstate Mi. Trowel Trades (1980)	$ 3.19	-0-	1.0	$ .48

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Region, State and Plan	Total Plan Assets (millions)	Level of UVL (millions)	Ratio of Plan Assets/Vested Benefits	Total Yearly Contributions (millions)
Ohio				
Asbestos Workers #8 (1978)	$ 2.81	---	---	$ .46
Bricklayers #6 (1979)	$ 1.36	-0-	1.0	$ .21
Bricklayers #8 (1978)	$ .83	---	---	$ .21
Bricklayers #22 (1980)	$ 1.73	---	---	$ .25
Bricklayers #55 (1980)	$ 2.58	$ .29	.91	$ .31
Bricklayers - Ohio (1978)	$ 3.02	$ .67	.82	$ .68
Carpenters - Miami Valley (1979)	$ 11.44	-0-	1.0	$ 1.39
Ohio Valley Carpenters (Cleveland) (1979)	$ 34.44	-0-	1.0	$ 3.12
Ohio Carpenters (State) (1981)	$ 120.05	-0-	1.0	$ 20.63
Plasterers & Cement Masons #109 (1981)	$ 3.35	-0-	1.0	$ .70
Cement Masons #524 (1982)	$ 2.12	-0-	1.0	$ .25
Cement Masons #536 (1980)	$ .33	-0-	1.0	$ .20
Glaziers #1162 (1978)	$ .84	---	---	$ .20
IBEW #38 (1978)	$ 13.70	---	---	$ 1.22
IBEW #82 (1978)	$ 7.50	---	---	$ 1.02
IBEW #246 (1978)	$ 2.70	---	---	$ .24
IBEW #540 (1978)	$ .70	---	---	$ .42
IBEW #573 (1978)	$ 1.95	-0-	1.0	$ .26
IBEW #648 (1978)	$ 2.05	-0-	1.0	$ .45
Ironworkers #17 (1976)	$ 17.02	$ 9.17	.65	$ 3.50
So. Ohio Ironworkers (1980)	$ 81.34	---	---	$ 13.59
Ironworkers - So. Ironworkers & Vic. (1982)	$ 104.33	$ 1.34	.98	$ 12.76
Laborers #310 (1978)	$ 15.70	---	---	$ 3.82
Laborers & Contractors of Ohio (1978)	$ 43.24	$ 6.64	.87	$ 12.29
Laborers (1980)	$ 105.49	---	---	$ 1.01
Ohio Operating Engineers (1980)	$ 174.19	-0-	1.0	$ 15.50
Painters #1275 (1977)	$ 1.32	---	---	$ .29
Toledo Painters (1977)	$ 1.02	---	---	$ .16
Plumbers #50 (1978)	$ 6.96	---	---	$ .81
Plumbers #55 (1977)	$ 9.65	---	---	$ 1.33
Plumbers #59 (1978)	$ 6.18	-0-	1.0	$ .98
Pipefitters #120 (1977)	---	---	---	$ 2.67
Plumbers #162 (1977)	$ 6.26	-0-	1.0	$ .60
Plumbers #189 (1980)	$ 7.83	-0-	1.0	$ 1.10
Plumbers #219	---	---	---	$ .38
Plumbers #225	---	---	---	$ .35
Plumbers #510 (1977)	$ 1.62	---	---	$ .27
Roofers #86 (1979)	$ 1.50	-0-	1.0	$ .18
Roofers #88 (1978)	$ 1.22	---	---	$ .76
Toledo Roofers #134 (1978)	$ 1.20	---	---	$ .35
Roofers - Ohio (1978)	$ 1.12	---	---	$ .19
Sheet Metal Workers #5 (1977)	---	---	---	$ .30
Sheet Metal Workers #70 (1978)	$ 3.45	---	---	$ .50
Sheet Metal Workers #98 (1979)	$ 6.51	-0-	1.0	$ 1.02
Sheet Metal Workers #141 (1977)	$ 5.68	$ 3.94	.59	$ .81
Western Pennsylvania				
Building Trades - W. PA (1977)	$ 14.99	---	---	$ 1.60
W. Pennsylvania Carpenters (1980)	$ 90.40	$ 5.49	.94	$ 1.38(5 yr. avg.)
Cement Masons #527 (1978)	$ 7.37	---	---	---
IBEW #5 & NECA W. PA (1978)	$ 16.75	-0-	1.0	$ 1.14
IBEW #721 (1979)	$ 6.01	---	---	$ 3.41
Heating, Piping, Air Cond. (1977)	$ 5.36	-0-	1.0	$ .35
Iron Workers - W. PA	---	---	---	$ 5.33
W. Pennsylvania Laborers (1980)	$ 89.80	$ 7.13	.92	$ 1.69(5 yr. avg.)
Operating Engineers #66 (1978)	$ 50.38	$ 63.1	.44	$ 7.25
Operating Engineers (1980)	$ 74.30	$ 21.4	.78	$ 1.26(5 yr. avg.)
Plumbers (1980)	$ 4.97	-0-	1.0	$ .42
Plumbers #115 (1978)	$ 3.64	---	---	$ .70

Region, State and Plan	Total Plan Assets (millions)	Level of UVB (millions)	Ratio of Plan Assets/Vested Benefits	Total Yearly Contributions (millions)
Western Pennsylvania cont.				
Teamsters Construction (1977)	$ 8.41	---	---	$ 1.08
Teamsters - W. PA (1979)	$ 151.30	$ 61.66	.71	$ 27.76
Teamsters (1980)	$ 15.92	-0-	1.0	---
Wisconsin				
Milwaukee 4 County Bldg. Trades (1980)	$ 147.22	$ 61.25	.71	---
Wisc. State Carpenters (1980)	$ 35.10	-0-	1.0	$ 5.37
Wisc. Cement Masons (1980)	$ 6.35	---	---	$ .98
Electrical Constr. Industry (1980)	$ 10.20	-0-	1.0	$ 1.38
Milwaukee Drivers	$ 19.66	$ 4.60	.81	$ 2.92
Wisc. Laborers (1980)	$ 11.69	-0-	1.0	$ 2.06
Plumbers #298 (1979)	$ 6.37	-0-	1.0	$ 1.02
MID-WEST REGION				
Iowa				
Plumbers #212 (1980)	$ 1.41	$ .27	.84	$ .17
Plumbers #387 (1979)	$ 3.15	---	---	$ .42
Kansas				
Kansas City Cement Masons	$ 2.08	---	---	$ .23
Construction Trades (1980)	$ 15.63	-0-	1.0	$ 2.09
IBEW #226 (1979)	$ 3.66	---	---	$ .72
Plumbing & Pipefitting - Wichita (1979)	$ 1.78	---	---	$ .11
Minnesota				
Twin City Bricklayers (1980)	$ 9.41	-0-	1.0	$ 1.29
Twin City Carpenters & Joiners (1979)	$ 38.75	-0-	1.0	$ 6.52
Wisconsin State Carpenters (1979)	$ 35.10	-0-	1.0	$ 5.77
Twin City Cement Masons (1979)	$ 5.27	-0-	1.0	$ .69
IBEW #292 (1979)	$ 12.10	---	---	$ .86
Twin City Ironworkers (1979)	$ 13.98	$ 1.24	.92	$ 2.37
Minnesota Laborers (1980)	$ 41.83	-0-	1.0	$ 5.04
Plumbers #539 (1979)	$ 2.61	---	---	$ .39
Sheet Metal Workers #547 (1979)	$ 3.53	-0-	1.0	$ .44
Minnesota Sheet Metal Workers (1979)	$ 5.68	$ .34	.94	$ .47
Minnesota Teamsters - Constr. Div. (1980)	$ 8.10	$ 1.99	.8	$ 1.35
Missouri				
Asbestos Workers #27 (1980)	$ 3.74	---	---	$ .69
Carpenters - Kansas City (1979)	$ 18.90	---	---	$ 2.20
St. Louis Carpenters (1980)	$ 59.15	-0-	1.0	$ 8.96
Carpet, Linoleum, Hard Wood & Resilient Tile Layers (1978)	$ 3.78	---	---	$ .67
Glaziers #558 (1980)	$ 2.46	---	---	$ .68
Missouri - Kansas Iron Workers (1979)	$ 12.49	$ 8.53	.59	$ 3.04
St. Louis Ironworkers (1980)	$ 44.18	$ 8.40	.84	$ 7.14
St. Louis Laborers (1980)	$ 18.82	$ 23.18	.45	$ 3.93
Operating Engineers #101 (1979)	$ 30.74	---	---	$ 4.38
St. Louis Operating Engineers #513 (1980)	$ 30.54	-0-	1.0	$ 3.75
Pipefitters #533 (1979)	$ 14.20	-0-	1.0	$ 1.93
Pipefitters #562 (1978)	$ 27.08	---	---	$ 2.57
Plasterers and Masons #527 (1980)	$ 8.72	$ 2.22	.8	$ .83
Plumbers #8 (1979)	$ 7.35	$ 5.02	.59	$ 1.06
Plumbers #35 (1979)	$ 8.07	$ 4.73	.63	$ 1.13
Sheet Metal Workers #36 (1979)	$ 12.83	$ 3.59	.78	$ 1.21
Sheet Metal Workers #93 (1979)	$ 1.76	---	---	$ .23
Nebraska				
Lincoln Construction Industry (1980)	$ 3.07	$ .05	.98	$ .31
Omaha Construction Industry (1980)	$ 24.73	$ 11.92	.67	$ 2.23

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Region, State and Plan	Total Plan Assets (millions)	Level of UVL (millions)	Ratio of Plan Assets/Vested Benefits	Total Yearly Contributions (millions)
Nebraska cont.				
Contractors, Laborers, Teamsters & Engineers (1980)	$ 8.87	-0-	1.0	$ 1.33
IBEW #22 (1979)	$ 5.06	---	---	$ .79
Plumbers #16 (1980)	$ 3.81	$ .83	.82	$ .44
Steamfitters #464 (1979)	$ 7.34	---	---	$ 1.44
SOUTH WEST REGION				
Arkansas				
Carpenters of Arkansas (1980)	$ 2.73	-0-	1.0	$ .37
Little Rock Carpenters (1980)	$ 2.72	-0-	1.0	$ .35
Louisiana				
Asbestos Workers #53 (1980)	$ 11.84	$ 3.55	.77	$ 2.17
Bricklayers #1 (1980)	$ 1.79	$ .07	.96	$ .16
Bricklayers #5 (1979)	$ .62	$ .03	.95	$ .15
Lake Charles Bricklayers #4, #6 & #7 (1980)	$ .49	-0-	1.0	$ .13
Baton Rouge Carpenters (1980)	$ 9.33	-0-	1.0	$ 2.14
Lake Charles Carpenters & Pile Drivers #953 (1980)	$ 2.52	-0-	1.0	$ .66
New Orleans Carpenters (1980)	$ 15.26	-0-	1.0	$ 2.67
Northeast Carpenters (1980)	$ 2.95	-0-	1.0	$ .44
Cement Masons #567 (1980)	$ 1.04	-0-	1.0	$ .13
Cement Masons (Lafayette AFL-CIO) (1980)	$ .31	-0-	1.0	$ .08
New Orleans Electrical Workers (1979)	$ 5.50	---	---	$ 1.19
New Orleans Sheet Metal Workers (1980)	$ 3.59	$ 6.08	.87	$ 1.06
Oklahoma				
Oklahoma Bricklayers & Cement Masons #1 (1980)	$ 1.53	-0-	1.0	$ .23
Tulsa Bricklayers #[illegible] (1980)	$ 2.59	-0-	1.0	$ .34
IBEW #584 (1979)	$ 2.60	---	---	$ .51
Texas				
Austin Bricklayers #8 (1980)	$ .48	-0-	1.0	$ .16
Gulf Coast Bricklayers (1980)	$ 3.78	$ 1.19	.76	$ .87
San Antonio Bricklayers (1980)	$ .69	-0-	1.0	$ .13
Houston Carpenters (1980)	$ 42.58	$ 3.13	.93	$ 8.89
North Texas Carpenters (1980)	$ 5.64	-0-	1.0	$ 2.80
Sabine Area Carpenters (1980)	$ 3.57	$ 3.08	.54	$ 1.01
South Texas Carpenters #1423 (1980)	$ 1.20	-0-	1.0	$ .23
Cement Masons #[illegible] (1980)	$ 1.35	$ .62	.69	$ .41
Cement Masons #681 and #177 (1980)	$ 3.74	$ .26	.94	$ .82
Cement Masons & Plasterers #783 (1980)	$ .43	-0-	1.0	$ .17
Dallas Cement Masons	$ 1.87	-0-	1.0	$ .57
Ft. Worth Cement Masons (1980)	$ .25	$ .04	.86	$ .12
Texas Iron Workers (1980)	$ 71.72	-0-	1.0	$ 14.36
Sabine Area Pipefitters #195 (1980)	$ 36.07	$ 19.83	.45	$ 2.58
Plumbers #[illegible]	$ 10.23	$ 4.07	.72	$ 1.64
Plumbers & Pipefitters #142 (1979)	$ 3.14	$ 3.36	.48	$ .52
Houston Teamsters #[illegible] (1980)	$ 1.22	.69	.64	$ .28
WESTERN REGION				
Alaska				
Alaska Carpenters (1980)	$ 53.88	-0-	1.0	$ 3.95
Alaska Electrical Contractors & IBEW #1547 (1979)	$ 61.12	---	---	$ 10.90
Alaska Iron Workers (1979)	$ 14.48	---	---	$ .95
Alaska Laborers (1980)	$ 110.91	-0-	1.0	$ 6.43
Operating Engineers #302 & #612 (1980)	$ 292.61	-0-	1.0	$ 23.63

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Region, State and Plan	Total Plan Assets (millions)	Level of UVL (millions)	Ratio of Plan Assets/Vested Benefits	Total Yearly Contributions (millions)
Alaska cont.				
Teamsters #959 (1979)	$ 205.08	-0-	1.0	$ 5.81
Alaska Trowel Trades (1980)	$ 3.15	-0-	1.0	$ .29
Arizona				
Arizona Carpenters (1980)	$ 56.19	$ 6.52	.9	$ 8.10
IBEW #570 & #518 (1979)	$ 7.99	$ 1.31	.86	$ 3.11
IBEW #640 (1978)	$ 11.01	$ .47	.96	$ .99
Arizona #395 (Laborers, Masons, Teamsters) (1980)	$ 101.78	-0-	1.0	$ 13.77
Operative Engineers #428 (1980)	$ 52.23	-0-	1.0	$ 7.29
Operative Masons/Plasters #394 (1980)	$ 9.65	$ 1.17	.89	$ 1.47
Operative Plasterers & Cement Masons (1979)	$ 5.90	$ 4.78	.55	$ 1.16
Arizona Pipe Trades (1980)	$ 47.87	-0-	1.0	$ 6.48
Arizona Sheetmetal (1980)	$ 8.24	$ .42	.95	$ 1.39
California				
Bricklayers #7 (1978)	$ 2.85	$ 1.67	.63	$ .39
Bricklayers #11 (1979)	$ 2.96	---	---	$ .57
No. Calif. Carpenters (1980)	$ 315.20	$ 459.16	.41	$ 69.62
San Diego Carpenters (1980)	$ 73.41	$ 6.39	.92	$ 8.52
So. Calif. Carpenters (1980)	$ 370.66	$ 372.66	.5	$ 71.36
No. Calif. Cement Masons (1980)	$ 56.34	$ 15.01	.78	$ 6.30
San Diego Cement Masons (1980)	$ 12.45	-0-	1.0	$ 1.3[illegible]
So. Calif. Cement Masons (1980)	$ 58.56	$ 22.85	.72	$ 9.04
IBEW #100 (1979)	$ 4.61	---	---	$ .92
IBEW #332 (1979)	$ 14.18	---	---	$ 4.65
IBEW #340 (1979)	$ 8.66	---	---	$ 1.05
IBEW - So. Calif. (1979)	$ 99.90	$ 109.50	.48	$ 22.56
IBEW - Pacific Coast (1979)	$ 15.63	$ 4.80	.77	$ 3.69
Alameda County Electrical Workers (1980)	$ 12.93	$ 8.94	.59	$ 2.88
Electrical Constr. Ind. - San Mateo (1979)	$ 5.64	---	--	$ 1.41
Electrical Workers - Solano, Napa Counties (1979)	$ 1.58	---	---	$ .49
Electrical Workers - No. Calif. (1979)	$ 10.31	$ 12.03	.46	$ 1.80
National Electrical Contractors (1979)	$ 25.55	---	---	$ 6.09
Redwood Empire Electrical Workers (1979)	$ 1.39	---	---	$ .14
Resilient Flooring Covering Pen. Trust (1979)	$ 41.49	---	---	$ 5.26
So. Calif. Flooring Covering Ind. (1979)	$ 15.77	---	---	$ 2.07
Glaziers & Glass Workers	$ 17.45	---	---	$ 2.96
Hod Carriers #36 & #291 (1979)	$ 2.15	---	---	$ .30
Hod Carriers #166 (1979)	$ 4.93	$ .60	.89	$ .88
Hod Carriers #234 (1979)	$ 2.87	---	---	$ .48
Calif. Ironworkers (1980)	$ 88.23	$ 130.74	.4	$ 34.97
Constr. Laborers - San Diego County (1979)	$ 44.83	---	---	$ 14.43
No. Calif. Laborers (1980)	$ 193.49	$ 207.40	.48	$ 40.44
So. Calif. Laborers (1980)	$ 215.03	$ 514.18	.3	$ 80.57
Lathing Industry of Calif. (1979)	$ 5.67	---	---	$ .74
Metal Lathing Ind. - Los Angeles (1978)	$ 5.30	---	---	$ .51
So. Calif. Operating Engineers (1980)	$ 269.90	$ 412.17	.4	$ 69.34
Painters - Orange Belt (1979)	$ 31.13	$ 8.06	.79	$ 6.62
Pipe Trades District Council #36 (1980)	$ 36.10	$ 24.50	.6	$ 4.60
Plastering Industry - No. Calif. (1980)	$ 12.66	$ 4.43	.74	$ 2.49
San Diego Plasterers (1979)	$ 4.06	$ 5.70	.42	$ 1.03
Plumbing, Heating, Piping Ind. of So. Calif. (1980)	$ 203.74	---	---	$ 32.71
Plumbers & Pipefitters, UA #38 (1979)	$ 19.70	$ 16.82	.54	$ 3.78

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Region, State and Plan	Total Plan Assets (millions)	Level of UWL (millions)	Ratio of Plan Assets/Vested Benefits	Total Yearly Contributions (millions)
California cont.				
Pacific Coast Roofers (1978)	$ 20.67	---	---	$ 4.45
Roofers - Santa Clara County (1979)	$ 1.83	$ 1.65	.53	$ .70
No. Calif. Tile Industry (1980)	$ 3.73	$ 1.70	.69	$ .98
Colorado				
Colorado Brickmasons (1980)	$ 5.86	$ 3.66	.62	$ .82
Centennial State Carpenters (1980)	4 38.02	$ 24.96	.6	$ 7.71
Colorado Cement Masons (1980)	$ 5.47	$ 1.31	.81	$ .88
Colorado Contractors Open Shop Workers (1979)	$ 1.93	---	---	$ .33
Ironworkers #507 (1979)	$ 1.62	$ .65	.71	$ .25
Colorado Ironworkers (1979)	$ 11.55	$ 8.24	.58	$ 2.12
Hawaii				
Carpenters (1980)	$ 73.40	$ 55.35	.57	$ 13.39
Hawaii Reinforcing Iron Workers (1978)	$ 4.54	$ 1.51	.75	$ .67
Laborers (1980)	$ 40.37	-0-	1.0	$ 6.29
Masons (1980)	$ 26.77	-0-	1.0	$ 2.13
Roofers #221 (1979)	$ 1.43	---	---	$ .15
Sheet Metal Workers (1979)	$ 9.95	---	---	$ 1.16
Idaho				
Carpenters - Rocky Mt. District Council (1980)	$ 5.43	$ 2.33	.70	$ 1.00
Laborers (1979)	$ 6.24	---	---	$ 1.39
Montana				
Montana Cement Masons (1980)	---	-0-	1.0	---
Montana Cement Masons (1980)	$ 7.80	-0-	1.0	---
Nevada				
No. Nevada Carpenters (1979)	$ 13.32	-0-	1.0	$ 2.95
So. Nevada Carpenters (1978)	$ 23.56	-0-	1.0	$ 4.03
No. Nevada Laborers (1979)	$ 6.23	---	---	$ 1.44
So. Nevada Laborers (1980)	4 17.66	-0-	1.0	$ 3.67
Plumbers & Pipefitters #525 (1979)	$ 14.41	$ 3.40	.97	$ 2.42
New Mexico				
Carpenters - New Mexico Distr. Council (1980)	$ 12.36	$ 13.54	.48	$ 2.88
New Mexico Pipe Trades (1980)	$ 10.85	$ 9.66	.53	$ 2.30
Sheet Metal Workers (1980)	$ 2.19	$ 1.83	.55	$ .55
Oregon				
Northwest Bricklayers (1979)	$ 6.05	---	---	$ .82
Oreg. Wash. Carpenters (1980)	$ 67.40	$ 16.30	.81	$ 8.40
Cement Masons (1980)	$ 7.00	-0-	1.0	$ .93
Edison Pension Trust (1979)	$ 12.34	$ .13	.97	$ 2.72
N.W. Ironworkers (1980)	$ 43.80	$ 10.20	.81	$ 12.10
Western Glaziers Rtmt. Trust (1979)	$ 2.31	---	---	$ .35
Oregon Laborers (1980)	$ 46.60	---	---	$ 6.70
Operating Engineers #701 (1980)	$ 68.30	$ 7.00	.91	$ 9.40
Operative Plasterers #82 (1979)	$ 1.54	---	---	$ .32
Plumbing & Pipefitters #51 & #235 (1979)	$ 24.46	---	---	$ 2.77
Plumbers & Fitters #481 (1980)	$ 4.24	---	---	$ .40
Oregon Plumbing & Pipefitting Ind. (1980)	$ 5.71	---	---	$ .67
Oregon Sheet Metal Workers (1979)	$ 11.83	---	---	$ 1.69
Utah				
Masonry Pension Trust (1979)	$ 1.01	---	---	$ .14

Region, State and Plan	Total Plan Assets (millions)	Level of UVL (millions)	Ratio of Plan Assets/Vested Benefits	Total Yearly Contributions (millions)
Washington				
Bricklayers #2 (1979)	$ 2.29	---	---	$ .19
W. Washington Carpenters (1980)	---	-0-	1.0	---
Wash. - Ida. Cement Masons (1980)	$ 3.74	-0-	1.0	$ .67
W. Washington Cement Masons (1980)	---	-0-	1.0	---
IBEW #191 (1979)	$ 1.52	---	---	$ .37
Puget Sound Electrical Workers (1979)	$ 8.66	---	---	$ 2.88
Engineers (1980)	$ 36.77	-0-	1.0	$ 8.07
Engineers - Inland Empire (1980)	$ 29.77	-0-	1.0	$ 5.18
Laborers - AGC of Montana (1979)	$ 8.74	-0-	1.0	$ 1.20
Wash. - Ida. Laborers (1980)	$ 21.50	-0-	1.0	$ 4.09
W. Washington Laborers (1980)	---	$ 58.92	---	---
Operating Engineers #302 & #612 (1980)	---	-0-	1.0	---
Plasterers & Cement Masons (1980)	$ 9.68	-0-	1.0	$ 1.85
Idaho Plumbers & Pipefitters (1979)	$ 5.09	---	---	$ .62
Northwest Sheet Metal Workers (1979)	$ 13.11	---	---	$ 1.95
Wyoming				
Carpenters (1980)	$ 6.22	-0-	1.0	$ .87

Region, State and Plan	Total Plan Assets (millions)	Level of UVL (millions)	Ratio of Plan Assets/Vested Benefits	Total Yearly Contributions (millions)
NATIONAL & WIDE AREA PLANS				
Boilermaker National Pension Trust (1979)	$ 537.25	---	---	$ 78.36
Bricklayers and Trowel Trades Int. (1980)	$ 79.87	$ 94.04	.46	$ 24.83
Carpenters Labor-Mgmt. Fund (1980)	$ 29.00	-0-	1.0	$ 5.90
Ironworkers Mid-South (1979) +	$ 33.67	$ 4.58	.88	---
Laborers National (1980)	$ 256.69	-0-	1.0	$ 41.22
New Engl. Teamsters and Trucking (1979)	$ 393.43	---	---	$ 72.04
Operating Engineers Central (1980)	$ 569.78	-0-	1.0	$ 85.81
National Roofing Industry (1977)	$ 25.73	-0-	1.0	$ 5.82
Central States Teamsters (1980)	---	$3.57 billion	---	$2.1 billion
Southern Conf. of Teamsters (1979)	$ 15.86	$ .23	.99	$ 2.08
Western Conf. of Teamsters (1981)	$3.7 billion	$1.6 billion	.67	$ 464.15
Pension Trust - Operating Eng. of No. Calif., Nev., Ut., & Ha. (1980)	$ 390.00	$ 26.08	.94	$ 46.20
Wash. - Ida. - Mont. Carpenters (1980)	$ 15.15	-0-	1.0	$ 6.11
	$15,128.57*	$5,285.44*	.84 (Cum. Avg.)	$8,010.72*
	(630 responses)	(419 responses)	(419 responses)	(641 responses)

* Totals do not include the Central States Fund nor the Western Conference of Teamsters Fund.

+ Plan had no unfunded vested benefits for withdrawal liability purposes.

Senator **Nickles**. You mentioned that there seemed to be a trend, or appearance of a trend, for employers in construction of moving away from defined benefit plans into defined contribution plans. Is that correct?

Mr. **Bell**. Yes.

Senator **Nickles**. Do you see that continuing or accelerating?

Mr. **Bell**. Very definitely accelerating.

Senator **Nickles**. You also mentioned a trend where companies in construction, since they were so leery of the potential withdrawal liabilities under defined benefit plans, did not really want to negotiate with the union plans. Is this accelerating a move toward open shop?

Mr. **Bell**. Yes; it is. There is also another aspect of this that we have to consider. Some owners of construction are dictating that their contractors have to work on an open shop or something closely akin to an open shop basis. We as business people have to respond to the markets that we have available to us.

Senator **Nickles**. There are about 1,000 construction industry defined benefit multiemployer plans; is that correct?

Mr. **Bell**. That is what we believe; yes.

Senator **Nickles**. Do you have an estimate on how many would have an unfunded vested liability problem?

Mr. **Bell**. We feel that approximately 50 percent of them have an unfunded vested liability problem, and that as much as 30 percent of the total are rather serious problems.

Senator **Nickles**. In light of the gravity of that problem, what would you think of some efforts in Congress being made to mandate that certain percentages of funds would go into mortgages or go into various types of what we call social investments?

Mr. **Bell**. We are opposed to social investing. Our primary responsibility is a fiduciary responsibility, and as trustees of the plans, we need to see that we get the maximum return on the funds that are in the plans.

Senator **Nickles**. Even if we had some percentage of that social investing moved into general construction?

Mr. **Bell**. We are opposed to that. There are people, of course, who do construction who support that type of legislation. However, when you look into it more carefully, you find out that they are all open shop, so they get the best of all worlds.

Senator **Nickles**. In your company, are you open shop, closed shop, or both?

Mr. **Bell**. No. Our company is a collective bargaining company.

Senator **Nickles**. Mr. Bell, we appreciate your statement before this committee.

Mr. **Bell**. Thank you.

[The following material was subsequently supplied for the record:]

Arent, Fox, Kintner, Plotkin & Kahn

Washington Square 1050 Connecticut Avenue, N.W
Washington, D.C. 20036-5339

Writer's Direct Dial Number

May 3, 1983

Charles T. Carroll, Jr.
Counsel
United States Senate
Subcommittee on Labor
Washington, D.C.

Dear Chuck:

This letter is in response to the list of questions you sent me earlier concerning the impact of the present withdrawal liability provisions on the Central States, Southeast and Southwest Areas Pension Fund (the "Fund"). I will respond to your questions by reference to the general subject matter groupings set forth in your letter.

Withdrawal Liability

You requested a statement of the Fund's general position as to the concept of withdrawal liability, the recovery rate that the Fund has experienced in terms of collections from solvent and bankrupt employers and the extent of legal expenses incurred to date by the Fund as a result of withdrawal liability litigation.

It is the general position of the Fund that the net impact of withdrawal liability has been detrimental, both in terms of discouraging new employers from participating in the Fund as well as in encouraging current employers to structure their affairs in a fashion which minimizes the extent of their participation in the Fund.

I understand that as of the end of 1982, total withdrawal liability assessments exceeded $220,000,000. Approximately $158,851,000 has been assessed in circumstances involving the bankruptcy of the contributing employer. Approximately $15,254,000 is attributable to the assessment of liability for partial withdrawal in situations involving employers who continue to participate in the Fund. An additional amount of approximately $30,543,000 has been assessed in situations involving litigation regarding the constitutionality of MEPPA and other matters.

Assessments actually collected and received by the Fund amount to approximately $236,000. In addition, the Fund has negotiated escrow arrangements which will involve future payments to the Fund of approximately $153,000 pending the outcome of some litigative challenges to the constitutionality of MEPPA. In addition, the Fund has negotiated bonding arrangements covering another $16,650,000. These figures do not include bonding arrangements which have arisen under the special sale of assets rules.

Given the relatively recent enactment of MEPPA, the Fund does not feel that it can project meaningful experience factors concerning collection rates against bankrupt employers. However, in noting that Section 4225(b) of MEPPA provides for a 50% reduction of the amount of withdrawal liability which can be assessed against a bankrupt employer, the Fund anticipates that its collection rate in bankruptcy would be somewhat under 10%.

As of March 15, 1983, legal costs expended by the Fund in the area of withdrawal liability exceeded $455,000. Many of these fees involve complex judicial challenges against the constitutionality of MEPPA.

The actual dollar costs associated with withdrawal liability have thus significantly exceeded the actual cash receipts collected by the Fund to date.

The incurrence of substantial legal fees may be a temporary phenomenon as the constitutionality issues will eventually be answered by the courts. Of far greater importance, however, are the long-term adverse consequences which the Fund perceives as implicit in the withdrawal liability area, which are described below.

Number of Contributing Employers

You inquired as to the number of organized employers that were not required to contribute to the Fund and the number of organized employers which have established new facilities which are either operated in a non-union fashion or which are not required to contribute to the Fund.

In general, the Fund only maintains records on behalf of employers which are obliged to make contributions to the Fund pursuant to an appropriate collective bargaining agreement. Accordingly, the Fund has no direct method for ascertaining the existence or operating characteristics of non-contributing employers, except in situations where the Fund has become apprised of a non-union situation in connection with its own collection efforts.

The Fund has, however, noticed a growing trend among employers to attempt to disengage from the Fund by spinning-off operations into non-contributing divisions or subsidiaries. A recent example involved a strike in Detroit where a very large employer insisted on terminating contributions to the Fund on behalf of one group of employees. The employer arranged to have enough of its other facilities in the same general area remain in the Fund so as to avoid assessment on the grounds of a partial withdrawal. After six to eight weeks on the picket line, the employees abandoned the resulting strike on a third vote and accepted a company designed profit-sharing plan as an alternative to the Fund.

The Fund has become aware of many recent instances where employers have offered IRA's or other separately designed arrangements as an alternative to continued Fund participation. While the Fund is not in a position to assess the underlying objectives of employers in each case, informal conversations with employer representatives have usually disclosed a fear of future withdrawal liability as the primary motivation in the employer's attempts to limit its involvement with the Fund.

Future Growth

You requested the views of the Fund as to future growth trends in terms of participants, contributing employers, assets and unfunded vested liabilities.

The Fund has been afflicted by the general problems of the trucking industry in terms of reduction in contribution-base units. While the Fund has made no formal projections as to contribution-base unit trends, it is concerned that the double impact of adverse industry conditions and the generally negative sentiments of employers due to withdrawal liability may cause future funding difficulties.

The Fund has enjoyed a significant increase in its size over the last year due primarily to favorable investment experience. The increase in asset size due to investment experience has caused somewhat of a reduction in total unfunded vested benefits. The Fund realizes, however, that it cannot continue to rely upon investment performance as a cure to decreases in its contribution-base units and strongly urges appropriate legislative correction of what has become a significant disincentive to participation in multiemployer defined benefit pension plans.

Very truly yours,

John C. Culver

Senator **Nickles**. Thank you. The meeting is adjourned.

[Whereupon, at 11:53 a.m., the subcommittee was adjourned.]

OVERSIGHT OF PRIVATE PENSION PLANS, 1983

TUESDAY, MAY 24, 1983

U.S. SENATE,
SUBCOMMITTEE ON LABOR, OF THE COMMITTEE
ON LABOR AND HUMAN RESOURCES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 9:30 a.m., in room 430 Dirksen Senate Office Building, Senator Don Nickles (chairman of the subcommittee), presiding.

Present: Senators Nickles, Hatch, Kennedy, Pell, Riegle, and Matsunaga.

Senator NICKLES. Good morning.

Also present: Senators Boschwitz and Inouye.

OPENING STATEMENT OF SENATOR NICKLES

Senator NICKLES. Good morning.

Today, the Labor Subcommittee will again focus its attention on the health of the private pension system. We are privileged to have Senator Jacob K. Javits, the former ranking minority member of this committee, appear before us today. Senator Javits' expertise on the private pension system is certainly beyond question. He coauthored the Employee Retirement Income Security Act, known as ERISA, some 10 years ago and was instrumental in obtaining its final passage.

Our second witness is Robert R. Midkiff, president of the American Trust Co., of Hawaii, who is also a recognized private pension expert, having set up numerous plans of every type over the past 10 years.

Since its inception, the impact of ERISA on the private pension system has been, on balance, positive, as demonstrated at the March 21 hearing before this subcommittee. However, unforeseen problems have arisen and need to be dealt with in order to keep the system healthy. These hearings are designed to direct the focus of this subcommittee to those problems.

Senator Javits, we welcome you before this committee and also your expertise and your willingness to share your thoughts with us. Before you have a statement, we also welcome the chairman of the Labor Subcommittee, Senator Hatch.

Senator HATCH. Thank you, Senator Nickles.

I join Senator Nickles in extending hearty welcome to our good friend and distinguished colleague, Senator Javits. His coming here today is a most auspicious occasion for the committee for I can think of no other member who has been held in higher esteem by his colleagues than Senator Jack Javits.

Over the years, he has been one of the select few whose wise counsel was continually sought out by members on both sides of the aisle and across the political spectrum.

Senator Everette Dirksen once said to his son-in-law, our current majority leader, Howard Baker, "There is one man in the Senate who is so clearly intellectually superior and whose judgments and insights are so keen and whose ability as a lawyer is so valued that I urge you to listen and to listen carefully to the advice of Jack Javits."

I am grateful that during my first years in the Senate I had an opportunity to take Senator Dirksen's recommendation to heart and seek Jack's counsel. One could not have had a better apprenticeship under a greater Senator.

There were times, of course, when I could not agree with Jack on an issue, and in those instances I simply found solace in Everette Dirksen's other comment which he reportedly made with a grin in his eye, "Don't listen too carefully. He is not always right, but he is very persuasive and he is the Senate's lawyer," [laughter] and so he was.

But it was not simply for the benefit of his colleagues that Jack brought to bear his wealth of intellect and wisdom and his deep dedication to justice and equity. It is the Nation itself and its working people who owe Senator Javits an unrepayable debt of gratitude.

Today's workers enjoy the protections of a rich array of Federal laws covering all facets of their employment experience and extending into their retirement years. Under his leadership, the Congress and this committee over a span of over 2 decades aggressively tackled the problems growing out of employment discrimination, workplace health and safety, job training, workers compensation, pensions and a host of other issues.

I know that Jack takes a special pride in his coauthorship of ERISA, and indeed, he should. Private pensions are a means by which workers can provide an income for a decent living in the older years. It is an integral part of the complex system by which this great nation promotes the welfare of its people.

As Senator Javits himself noted at the time of ERISA's passage, the worker works for that pension the same way he works for his wages or salary, and when he does not get it or some reasonable portion of it, he is angry, frustrated, ultimately convinced that he has been robbed of a material recognition that was due him.

Thus assuring the payment of promised pension benefits is not only a matter of economic justice, it is vital to the success of our capitalist system.

Today the committee is reviewing the current health and future prospects of her private pension system under ERISA. I think we are very fortunate to have Jack's valued assessments and insights as well as his recommendations.

As a young Senator who came here having never held public office before and came on this really most difficult of all committees in the Senate, I have to tell you that the power on this committee has been, was and I think still is in many respects the Honorable Senior Senator from New York, Jacob Javits.

And I just want him to personally know the deepness of my feelings, the depth of my feelings for him and the love and affection that I think every member of this committee who has served with him has and those who served with him who are no longer here have for the great Senator Jack Javits.

I have said myself that there has never been a Senator with a greater intellect or a greater ability to advocate his causes and his principles than Senator Javits, and that has not changed since he has left the Senate.

I am so happy to welcome you here, Jack, and glad to have you before the committee.

Senator NICKLES. Thank you, Mr. Chairman.

Senator Pell, did you have any comments?

Senator PELL. Thank you, Mr. Chairman.

I just want to join in welcoming from the bottom of my heart our old colleague, the Senator from New York, here. We served on the same committees, both Foreign Relations and this committee, and I do not think in the years I served in the Senate I have seen any other Senator leave his imprimatur on as many pieces of legislation as has Senator Javits.

I have seen the process take place no matter whether it is the subcommittee level, the full committee level or the Senator floor or in the conference but time and time again whether it concerned domestic affairs, health, education, labor or foreign relations, any of the various aspects of that, arms control, Presidential powers, the imprimatur of Senator Javits was always very visible, indeed.

He did it in a very tactful and subtle way so one did not realize that his imprimatur was on it and the credit often went to his colleagues and others who were never shy about accepting that credit.

Speaking personally, I think Senator Javits knows the depth of my affection for him and I welcome him here.

Senator NICKLES. Thank you very much, Senator Pell.

Senator Kennedy.

Senator KENNEDY. Thank you, Mr. Chairman.

Jack Javits is a man of prodigious energy and great wisdom and exemplary courage. Few who have served in this body have made a larger contribution or served with greater distinction. His surpassing commitment to the service of his country made him one of the most respected men in American public life.

For 23 years he represented the State of New York with a vigor and compassion that is all too rare, provided leadership on virtually every issue of national and international significance that came before this body.

For many years Senator Javits and I worked closely together on this committee, especially on the Health Subcommittee which I chaired and on which he served as the ranking minority member.

During that period, he made a truly significant contribution toward improving the health care system of this country. He was instrumental in helping enact the Health Maintenance Organization Act of 1975, War on Cancer Act of 1971, the legislation regulating biomedical research, to name just a few of his numerous achievements in the field.

He shares our pride in the extraordinary accomplishments of that extraordinary era of compassion and achievement in the Congress. The complete record of Jack Javits in the Senate is simply too long to detail, but three measures are clearly of historic significance.

In 1964, he was instrumental in forging the coalition that made passage of the historic Public Accommodations Act that year a reality. It was the first great civil rights legislation of the modern era, and it paved the way for two other vital measures on which Jack Javits left his indelible stamp, the Voting Rights Act of 1965 and the Fair Housing Act of 1968.

No measures since the adoption of the 14th amendment have done more to fulfill the promise of equal justice under law, and perhaps his greatest achievement was the War Powers Act. In 1973, he drafted and then worked tirelessly for the enactment of that landmark legislation which, for the first time, clearly established the shared responsibility of Congress with the President for the conduct of the war.

And finally, there was ERISA. Jack Javits was in large measure responsible for the enactment of the pension legislation which insured that American workers would receive the pension benefits they had earned during their working years.

Many other Senators joined this effort, but there is no doubt that comprehensive pension reform could not have been enacted without the vision and the tireless work of Jack Javits.

As we approach the 10th year anniversary of that historic law and begin a comprehensive view of the national pension policy, it is particularly appropriate that the father of ERISA is with us today.

Jack Javits is one of the truly outstanding legislators to have served in the U.S. Senate in our Nation's history, made an outstanding contribution to this institution, to this committee, and to our country. It is with a profound sense of respect and admiration and I must say friendship as well as each of the Kennedy brothers have had the good fortune of serving on this committee and to have shared the opportunity of enjoying his wisdom, his patriotism, and his compassion.

We welcome you back, Senator Javits.

Senator NICKLES. Thank you very much, Senator Kennedy.

I might, at this time, read a note from Senator Jennings Randolph which was written at his home. He says:

> Dear Jack.
>
> Please know, my cherished friend and long-time colleague, that even though I am not at the hearing on our Subcommittee on Labor that I shall be there with you in spirit and understanding.
>
> As the architect of ERISA legislation, your testimony will be constructive and welcomed.
>
> Truly, Jennings Randolph.

So I pass that.

Senator Inouye, did you have any comments or just want to say hello?

Senator INOUYE. Mr. Chairman, I thank you very much. I am not a member of this distinguished committee so I am here this morning to pay my respects to and demonstrate my love and affection to one who is truly a giant of the U.S. Senate.

Senator NICKLES. Thank you very much, Senator. You are always welcome at this committee.

Senator INOUYE. Thank you.

Senator NICKLES. Senator Javits, you are welcome to proceed with your statement or any comments.

STATEMENT OF HON. JACOB J. JAVITS OF TRUBIN, SILLCOCKS, EDELMAN, KNAPP LAW FIRM, NEW YORK, N.Y.

Senator JAVITS. Thank you, Mr. Chairman.

And of course, I am deeply moved by the reception which is very gratifying by the chairman of the committee, Senator Hatch; and its very long time and great activist, Senator Kennedy; one of my dearest friends, Senator Pell; and one of my most prized colleagues, Senator Inouye. I might add to that the name of John Stennis, who did me the great honor of coming to greet me this morning before the hearing.

I shall do my best to cast a little light on the ERISA which was the product of the work of this committee, including myself and its then chairman, Pete Williams of New Jersey, and in the long annals of history, his name must be connected with this very important legislation, as is mine, notwithstanding what may have occurred in his life. It might occur to anybody.

Now, Mr. Chairman, I made it a policy not to appear here unless I had something that had to be said and to defend something which I prized and millions of workers prize, and that is what I was here for.

So until the Lord decides that I am no longer marked present, I shall defend, work for, and endeavor to advance the causes in which I believe and the institution, the U.S. Senate to which I have given so much of my life and which I love.

Now, ERISA, in my view, was one of the most vital pieces of social legislation of our time. Indeed, I think as important as social security because unlike a lot of the common wisdom you hear that government is an imposition and that is arguable, except as to security, of course, and other comparable matters, but it does serve and can serve an extraordinary function of coordination.

It can pool skills and resources, not necessarily its own, but can facilitate their pooling so the people have the opportunity to help themselves, and that is, perhaps, a very modern function but a very real one and a very important one.

Senator Kennedy spoke quite truly of the health maintenance organizations which are a comparable proposition, and there are many of others, and this is one of them, but this is a big one.

You know, it is amazing to me, having just gone through the social security crisis and having just patched it up—that is all we did. You do not project it beyond the next 10 or 20 years at the most—and the jeopardy and the concern caused to so many millions of retired Americans that we should think of letting the steamroller roll over this one, too, because we have budget deficits, as if this were the cause of budget deficits.

The fact is that the pension system is just as essential as the social security system simply because a person retired cannot live on what the social security system alone produces, and we seem to forget that the very gifted provision of the IRA, which is a wonderful idea, was incorporated in this law at the very beginning. It was meant to be this way.

In addition, there are now twice as many, in round figures, pension plans as there were when this thing began in 1974. There are almost twice as many covered workers. Think of it, 50 million, one-half the aggregate work force, and there is now an enormous investment pool of capital amounting to, again, double what it was, now well over $600 billion. Staggering figures. There are not 10 million beneficiaries of private pensions. Again, about half of the retired people.

So it would be unthinkable to dismantle this system because of a temporary difficulty.

Now, there are some $150 billion of tax expenditure on our books of which in fiscal 1983 the pensions covered by ERISA accounted for about $26 billion, and let us remember that these tax expenditures include interest on home mortgages and exemptions from the sale of homes by people over, I think it is 55, and also let us remember that one the beneficiaries get their pensions, they will have to pay taxes.

So my feeling is very strong on that subject.

Given the issue, it seems to me that we could make reforms. Reforms are needed. I helped to make reforms when I was here in both the employer plans, and I am sure, like any other law, the committee needs to modernize and keep up with events,

Let us remember now that while $30 billion is estimated to have gone into IRA's, over $600 billion has gone into these pension plans, and that juxtaposition has to be kept clearly in mind.

Now, the attack which is brewing is maining on defined benefit plans, that is, those plans where a certain income to the beneficiary is assured as contrasted with the defined contribution plan, which by the way are more numerous, where the income to the beneficiary will depend not only on the contributions but on investments, et cetera, and is left in an undefined or uncrystalized position.

Naturally, having fought for with workers for all my life, I favor the defined benefit plan, but again, that is one of those elements which is fluid in the sense that sure it needs to be reconciled with IRAs, Keoghs and other new forms of investment.

But again, let us not threaten the whole system because of some idea that it is outmoded. It is very much in order, and very definitely an element in the retirement system which is one of the proudest and best things we have in this country and which unlike many welfare models like those in Europe, relies upon individual initiative, individual contract, including collective bargaining and people earning, as was said here a minute ago, either directly in what they pay or indirectly in what the employer pays as a result of our own effort and for the operation of the private enterprise system.

If it is the last time I say it, and it may be easily—who knows?—I repeat again what I have said on the floor and in this committee room a thousand times, as long as the individual, or at least 90 percent of them in round figures, wears two hats, one as a citizen in government and the other as a private individual in the economy and does not owe his job to any government, so long as freedom is safe, and when that balance tilts, freedom is in peril, and this law and this system is one of the best means for keeping that true.

I would like, if I may, Mr. Chairman, now to make a few other observations on what I think needs your attention.

Senator HATCH. Certainly.

Senator JAVITS. First, women. There is a great period of readjustment in respect of the status of women. They live longer. In many ways, they are still the subject of discrimination, and the pension system is one of those areas which needs your attention, recognizing their new status and recognizing it not in terms of doctored or varied quality but in terms of the reality of equality, equal pay for equal work and equal opportunity.

I always recall, with some amusement, the struggle over equality of women in respect to college athletics and the nonsense about whether they should have football teams. It is a great tribute to the good sense of this institution that that issue was settled in conference, settled satisfactorily and without football teams.

The other subject is the changes in the law which may be dictated by the issue of eligibility for pensions which is, under present law, too long deferred. You go to work at 18. You cannot become vested for 7 years until you are 25. I think you ought to look into that.

And that old and difficult problem of portability. People do not stay that long with individual employers. A great example of that is engineers who may move from job to job, and I think that that portability still remains a problem.

I hope also you will look into the new practice of using pension funds as a means for acquiring other enterprises and consider what ought to be done about tightening up the rules which is fully within the province of this committee, the fiduciary rules respecting the use of pensions and takes, so-called.

And finally, the question of social investment, that is, whether there ought to be COLA on pension funds for health and housing and similar activities and whether there should be a distinction between the pensions of public employees and those of private employees.

Senator Hatch, that is my view on the present state of this law, but beyond anything else, I hope that as you consider the exegincies of our present budgetary situation you will not throw out the baby with the bath.

Thank you very much.

[The prepared statement of former Senator Javits follows:]

STATEMENT

OF

JACOB K. JAVITS

BEFORE THE SUBCOMMITTEE ON LABOR
COMMITTEE ON LABOR AND HUMAN RESOURCES
UNITED STATES SENATE
MAY 24, 1983

Mr. Chairman, I welcome this opportunity to appear before you to discuss the current health and future prospects of defined benefit pension plans. I appear today because of my interest in assuring the retirement security of millions of American workers. This concern led me to introduce pension legislation beginning in 1967 and in every Congress thereafter until 1974, when I became a principal co-author of the Employee Retirement Income Security Act of 1974, also known as "ERISA." In my view, this Act was as important a piece of social legislation as the Social Security Act of the thirties. ERISA introduced the element of reliability to the private pension system, and as the name of the Act indicates, the goal of ERISA was the security of employee retirement income. ERISA achieves this goal through, among other things, funding requirements, fiduciary rules, minimum standards on vesting, and plan termination insurance.

When ERISA was enacted into law in 1974, there were an estimated 425,000 pension plans falling under its jurisdiction with an estimated 194.5 billion dollars in assets, approximately thirty million covered workers and 7 million beneficiaries. By 1982, the estimate is that there were 745,000 plans under the Act's jurisdiction with 624 billion dollars in assets, 50 million covered workers and 10 million beneficiaries. The whole pension operation appears to be in reasonable financial balance.

Despite the crucial role of private pension plans, there have been suggestions to reduce the tax incentives for maintaining plans and to phase out defined benefit plans in favor of defined contribution plans and Individual Retirement Accounts ("IRA's"). These suggestions have been the subject of consideration both in the Senate and by the Congressional Budget office and others. The driving force behind these suggestions is the concern about revenue loss resulting from the existing tax incentives and the effect of this loss on the budget deficit.

The fiscal year 1983 budget projected that tax expenditures for pension plans would reach 27.5 billion dollars. This figure jumped, interestingly, to 56 billion dollars in the fiscal 1984 budget. The 1984 budget, however, does recognize that the private pension system may be the most efficient method for providing such benefits because the outlay equivalent figure (the direct federal budget outlay necessary to provide the same benefits) exceeds the tax expenditure amount. It is estimated that there will be almost 200 billion dollars of so-called "tax expenditures" for fiscal year 1984 including pension contributions, and we must be very strongly convinced that private pensions are to be penalized before encouraging any idea of curtailing them. Let us remember that unlike many other so-called "tax expenditures," taxes are collected from the pension beneficiaries on pensions they receive out of contributions paid by the employer.

Let us also remember that since World War II, there has generally been a public consensus to encourage the growth of tax-qualified retirement programs. Looking at the growth of these plans and their assets, we can say that we have done quite well. Since ERISA, newly available arrangements such as § 401(k) plans, simplified employee pensions, tax credit ESOP's and IRA's for employees have been made available by the Congress to increase retirement savings.

This pro-retirement-savings consensus, however, took a severe jolt last year when the Tax Equity and Fiscal Responsibility Act of 1982 ("TEFRA") reduced the maximum permissible benefits and contributions under qualified plans and imposed additional regulatory burdens. Many fear that a "TEFRA II" will be rushed through in 1983 because of budget concerns. I urge you, Mr. Chairman, and your colleagues on the Senate Labor Committee, not to let this happen.

Recent Treasury Department computations (released by the Congressional Joint Economic Committee in November, 1982) indicate that nearly 75% of those individuals benefited by the deductibility of pension contributions earn less than $50,000 per year. Approximately 34% of those benefited earn between $30,000 and $50,000 per year, almost 23% earn between $20,000 and $30,000 per year, and over 17% earn less than $20,000. According to this analysis, these tax expenditures, on the whole, benefit more middle-income individuals than the homeowner's mortgage interest deduction and the exclusion of capital gains on home sales by taxpayers who are 55 and older. Out of an estimated $156 billion of "tax expenditures" in 1982 for 33 separate tax expenditure items, net exclusion of pension contributions and earnings came to $26 billion, and in order of regressivity it ranked 17th.

I also urge you to oppose any efforts at phasing out defined benefit plans in favor of defined contribution plans and IRA's. Certain protections of ERISA like funding and plan termination insurance apply only to defined benefit plans. Such plans provide a specified benefit upon retirement, with employer contributions determined accordingly. In contrast, defined contribution plans require specific employer contributions, with no set level of benefit.

Of the two types of plans, the defined benefit plan, with the safeguards of ERISA, is the more appropriate vehicle for assuring retirement income security. The defined benefit plan puts the risk of providing the promised pension benefit on the employer. If investment experience is poor, the employer will have to increase his contributions to fund the plan properly. Employers have taken this responsibility seriously as evidenced by the fact that plans with over 1,000 participants (over 78% of all defined benefit plans) were 81% funded in 1981. Over 60% of smaller plans are 100% funded, and 81% of these are at least 75% funded. Many participants in these plans can look to their retirement with the firm expectation that their plan will have sufficient assets to pay a determinable monthly benefit.

Under the defined contribution plan, on the other hand, the employer's contributions are made according to a specific formula and are allocated to individual accounts. Most defined contribution plans are profit-sharing plans. Contributions under these plans are not even required under some circumstances, and the employer's duty to contribute depends solely upon the profitability of the company. The participant is entitled to the amounts allocated to his account, and that amount will fluctuate with the investment experience of his account and the plan as a whole. Thus, the participant can never expect a determinable monthly benefit because the investment risk in this sort of plan rests on the participant. There is no guarantee that the amounts in his account will provide a sufficient retirement income, even with Social Security, in the absence of other material means. He may be forced to rely primarily upon other vehicles for financial security upon retirement.

In addition, most defined contribution plans pay benefits in a lump sum, and may or may not provide for purchasing individual annuities. Many defined contribution plans provide for cash-outs upon separation from service for reasons other than retirement. Account balances may thus find their way into the hands of individuals who may have just lost their jobs and who may not roll over their pension distribution into an IRA. The defined benefit plan, in contrast, offers the retiree an income stream that is necessary in order to provide financial security throughout retirement.

The benefits under many defined benefit plans are expressed as a percentage of the participant's salary in the final years of his employment, thus reflecting economic conditions close to retirement. Even in collectively bargained plans, which typically provide a monthly retirement benefit of a fixed dollar amount per year of service, economic factors such as inflation are taken into consideration in setting the dollar amount in each contract negotiation. Defined benefit plans also are more flexible on the whole, and benefits can be adjusted, even retroactively, by the amortization of any required funding change. Such retroactive changes to defined contribution plans are extremely difficult.

The need for a secure income stream upon retirement will become more acute in the future. As the average age of the population of the United States increases, the demand for retirement income will accelerate. When the "baby boom" generation starts to retire early in the next century, there will be a great risk that our retirement income systems will be inadequate to meet the challenge. The recent Social Security amendments have increased the age at which full benefits become available and have, in effect, reduced benefits. This may put greater pressure on private pension plans. We should be taking steps now to encourage the health and growth of advance-funded, private pension plans, particularly defined benefit plans. It is none too soon to start amassing the kind of assets we will need for the "baby boom's" retirement.

Another important point in respect of ERISA is consideration of the idea of establishing an independent pension agency which would be the focal point for pension policy development and investment. Presently under the Act, these responsibilities are divided between the Labor Department, the Internal Revenue Service and the Pension Benefit Guaranty Corporation. This division remains a weak point in ERISA. The arrangement was a compromise in the ERISA conference in 1974 of a bitter contest about jurisdicton. The cooperation of both agencies concerned has softened the great disadvantage of this division of responsibility but has not dealt with the fundamental problem of weight on this subject. I would urge the Committee to give serious consideration of this question of responsibility for administration in connection with ERISA.

I understand personally why the Committee would want to take a close look at any budget or tax proposals affecting pension plans, considering our present and prospective grave problem of budget deficits. But I think it vital considering the millions of Americans affected, the vast amounts involved, the firm national policy in favor of providing and safeguarding retirement income and the weaknesses and inadequacies of the Social Security system already uncovered and upon which we have done only a patchwork job, that these issues are approached with great restraint and caution. It is the kind of situation where we could easily get ourselves into a much worse mess than we are in by an ostensibly "quick-fix" solution.

Thank you, Mr. Cnairman.

Senator NICKLES. Thank you very much, Senator Javits.

We appreciate your willingness and eagerness to provide us with your insights.

Senator Boschwitz, do you have any remarks you wish to make?

Senator BOSCHWITZ. No. I am just a visitor here, Senator Nickles, and I wanted to hear Senator Javits, testimony and I will take it along and read it, and it is nice to see him back up here on the Hill.

Senator NICKLES. Thank you very much for your appearance. You are certainly always welcome before this committee.

Senator Matsunaga, do you want to make comments?

Senator MATSUNAGA. Yes. Thank you, Mr. Chairman. I want to salute our former colleague, the distinguished former Senator from New York, who was a figure of olympian stature in the cause of civil rights and bipartisan foreign policy for our country as a member of the Senate for nearly a quarter of a century.

When Senator Javits left us in 1980, he had served the State of New York for four terms, which is the longest tenure ever recorded any individual in the Senate by the voters of New York.

His legacy to all the citizens of the Nation is his record of accomplishments in civil rights, social welfare, labor, and foreign policy legislation, not the least of these accomplishments was the Employee Retirement Income Security Act of 1974, which we are addressing this morning.

I was especially grateful for the assistance of the Senator from New York in getting Hawaii's prepaid health insurance plan adopted by the Senate, and it was primarily through his efforts that we were able to gain final recognition of the merits of the Hawaii State insurance plan.

I recall the Senator saying that the Hawaii prepaid health plan is the plan which the Nation should adopt, and I am happy to be able to report to you, Senator, that that plan has been included in ERISA as an exemption to the preemptive clause of ERISA, and the people of Hawaii owe you a deep debt of gratitude.

I certainly appreciate your appearance before this subcommittee this morning.

Senator NICKLES. Thank you very much, Senator.

Senator Javits, is it your belief that there is a role for both defined benefit plans and defined contribution plans and that Congress should encourage, not discourage the development of both?

Senator JAVITS. Yes, very definitely. I think it depends on the circumstances which have induced the different types of plans. Sometimes you cannot get a defined benefit plan. It takes a deal more of assurance by the employer, and certainly a defined contribution plan is better than no plan, though I prefer, as I stated, the defined benefit plan.

So I do not see any exclusionary attitude toward either plan.

Senator NICKLES. You also mentioned some other things this committee should consider. You mentioned faster vesting, whether or not funds could or should be based in takeovers.

You also mentioned social investing. Do you think it would be a mistake for Congress to encourage or mandate a social investing mode for plans?

Senator JAVITS. I think that I would give the priorities to tightening up on the misuse of pension funds. That is a very current problem. Then I would consider the social investment from the point of view of authorization, not mandate.

And I would certainly come with great reluctance to any idea of mandating, though I will recall to the members that New York City was saved from bankruptcy by the investment of the pension funds of the city workers.

So there is a clear distinction between public and private employees, but at this time, I would, as I say, approach mandating with a great reluctance. I do not think I would authorize it now.

There may come a time when you may consider that, but I would authorize more liberally social investment even if it does not meet fiduciary criteria but to a limited extent of pension fund assets and with the first thought of permitting it for public employees pension funds rather than private employees.

Senator NICKLES. On that same line, you mention public employees. Do you think Congress should move forward and try to come up with a comprehensive bill similar to ERISA for public employees?

Senator JAVITS. Well, I would like to hear the States and the cities on that subject, but I believe that there are many deficiencies and, and perhaps even some cases of aggrevated unfairness in public pension which deserve the attention of the Congress and respect of the regulation of nonpublic employee plans which come under ERISA.

Senator NICKLES. Thank you very much. Do you have any comments?

Senator HATCH. If I could just take a minute, Jack, and ask you just a couple of questions. An issue gaining prominence in the pension area is social investing. Now, this concept as I am sure you are aware is used to justify the investment of pension funds for social objectives such as the rebuilding of the industrial base of the Northeast or of the Midwest or the promotion of union jobs in construction.

Significantly, the concept of social investment wherein social investing could allow a pension fund to make investments that might not yield a maximum return for the benefit of retirees or the investment might entail, as another illustration, some added risk which a prudent fiduciary might not otherwise make.

Now, do you think the time has come to examine this issue? What would be your recommendations or guidelines to the committee with regard to the problems raised by this issue?

Senator JAVITS. I think the time has come to examine it. I have given the distinction between public and private employees, and I believe that time is brought nearer by the growth of pension assets, and therefore, the pool of capital which they command, it is conceivable that that could rise much greater than and over $600 billion, and you would be compelled to face that issue.

Frankly, I do not think you face it yet, but I like the word "examine." I think we ought to be willing to examine whether or not that time has come. But again I repeat ERISA does not regulate the funds of public employees, and I believe the case even for examination is much greater in that area than it is in private employment.

I would much rather see, knowing the time limitations which one has here, to examine many of these other questions especially that of women with higher priority.

Senator HATCH. This hearing today is not focusing directly on problems which have arisen under the 1980 multiemployer pension plan, but I am sure you are aware of some of the problems that have arisen under that, particularly the withdrawal liability that has caused what appears to be severe hardship on some employers.

I might mention the trucking industry feels that it has been especially hit hard with the withdrawal liability provisions, and I might also add that unions are finding that the 1980 act has been an impediment to organizing efforts.

Do you have any thoughts on how the Congress might rectify any of these problems with the 1980 act?

Senator JAVITS. Well, I think that the problem is confined to multiemployer plans obviously, and I believe that it should be examined on a high priority as to whether the taking of corporate assets or business assets is too great if an employer is forced out of business.

On the other hand, I think there ought to be a different criterion when an employer chooses to abandon the plan. With that distinction, I certainly believe that an examination is fully warranted in order to see, as you have said, whether it is an unfair liability considering its size, and I am sure that size of enterprise must also be a factor in that consideration, and I should imagine that you would want to look at that probably on high priority.

Senator HATCH. Thank you. It is really great to have you with the committee. Those of us who served with you feel very deeply toward you as you know.

Senator NICKLES. Thank you very much, Senator Hatch.

Senator Kennedy.

Senator KENNEDY. As I gather from at least part of your testimony, Senator Javits, that the need for this kind of an effort in the program is as great today, if not greater, than at any time in our past in that we have seen a rather dramatic shift and change in the makeup of the workforce which has had implications with regards to ERISA that we were not really able to predict or project at the times when that program was drafted earlier, both in terms of the movement of individuals, the types of people that might be participating, the greater entrance of women into the workforce and other kinds of implications.

As I gather from your strong testimony, it is that we ought to be analyzing each aspect of these programs, finding out how they are meeting the common objectives for which ERISA was established and where they are not meeting those objectives be measured against those objectives and then try, to the extent that we can, to pool our own abilities and to the extent that we can establish the fiscally sound ways of dealing with the financial challenges, establish a program which is certainly going to meet the objectives of the bill in the future for which you were so instrumental in establishing the bill in the past.

Senator Javits. My answer to that is decidedly yes, and I would add that you must be very careful that it has a future and that it does not become drastically impaired because of the present budget situation which is possible.

Senator Kennedy. We have certainly seen with the present budget situation where there have been appeals to the IRA's and other devices which obviously have some advantages for portability but certainly are not probably as widely available for those in the basic middle income and working people, working class people in our society because of being hard pressed in terms of the financial realities here today.

But what I understand you are saying is that what we ought to be trying to do is finding that kind of a mix, appropriate mix which is going to insure that the goal of ERISA for workers in our society is still going to be available and that we are not going to weaken in our basic commitment in the concept for which this program was established.

The times have changed. The makeup of the work force has changed. We ought to deal with those changes, but we certainly should not abandon what has been a very fundamental and basic commitment for the pension systems for millions of American people.

Senator Javits. Well, Senator Kennedy, one other factor, and I accept what you said and I agree with it, but there is one other factor. We are jumping up and down and tearing our hair about our lack of competitiveness and about the stability of our work force and about how well educated it is and about the modernization of the concept of work, giving the worker more participation even in decisionmaking as it is called on the shop floor and we want him intimately related to his employment with a deep personal interest and the greatest morale builder in the world is a private pension system, and so let us not tinker with what is good while we try to correct what is bad.

Senator Nickles. Thank you very much, Senator Kennedy.

Senator Javits, it is necessary for me to leave. I want to tell you again how much I appreciate your input and insights. You certainly have the respect and admiration of myself and the other members of this committee.

I will turn the chairmanship over to Senator Hatch, and again, thank you for your appearance today.

Senator Javits. Senator Nickles, I want to tell you how appreciative I am that you arranged this hearing to help me come down here and do it. Thank you very much.

Senator Nickles. Thank you.

Senator Hatch. Thank you, Senator Nickles.

Senator Pell.

Senator Pell. Thank you, Mr. Chairman.

I have just one general question. I would be interested in Senator Javits' thoughts as to how ERISA, if he was starting up now and was still with us, what he would do to change it to improve it at this time.

Senator Javits. Well, I will summarize again what I had in mind.

Therefore, it is necessary for me to give you the subjects which I suggest you deal with, and I am available should any member of the committee wish to take it up with me to consider individual changes that I could not pretend in testimony of reasonable compass to do more than that in appearing before the committee, and to recapitulate, I suggest in this order that you look at them.

The problem of women and their equality under pension systems. To look at the issues of eligibility of vesting, of portability, the rules of fiduciaries on corporate takeovers and finally, the issue of social investings and authorization in that field.

I think subsummed under those headings would be the matters that I have in mind, and I agree with Senator Hatch that you ought to look into the issue of penalty or liability in multiemployer plans which occur where you are forced out of business or in bankruptcy and where you wish to terminate a pension plan. Those are the issues to which I would address myself.

Senator PELL. Thank you very much.

The CHAIRMAN. Senator Matsunaga?

Senator MATSUNAGA. No questions, Mr. Chairman.

Senator JAVITS. Senator, before you pass. Thank you for your kind words and also I would tell you that without Ted Kennedy, we could not have done it.

The CHAIRMAN. Senator Riegle?

Senator RIEGLE. Thank you, Mr. Chairman. Senator Javits, I just want to say that it is a real inspiration for all of us to have you back with us today. In a sense, it feels as if you never really left us.

I do not think any person has given more distinguished service to the Senate or to our country than you have, and so it really is a great honor to have you back here with us today.

I think particularly you should know that by your example over your decades of service you made a great impact on many younger Members of the Senate and in the Congress generally and I certainly consider myself one of them, and I thank you for your example and for your leadership.

I might say so far this year on the four committees on which I serve I have had a chance to hear literally hundreds of witnesses, cabinet officers, and other witnesses of all sorts. I have not read a more incisive statement or heard a more incisive presentation than I have today from you. It clearly tops the list in terms of what I have heard from others and that actually is to be expected.

As I have gone through your statement, I am struck by your suggestion of an independent pension agency which I think is something we should do. The point you make about the divided jurisdictions and how that came about I think is a problem that we ought to find a way to fix, and I think that is a suggestion that I will want to pursue as I will pursue the other suggestions that you have made here.

But I want to say that in terms of really coming directly to the heart of the issue, I feel you have done that with your testimony. That has always been your hallmark and it is just a delight to have you here before the committee today.

Senator JAVITS. Thank you, Senator Riegle, and thank you very much for reminding me that my statement does include reviewing the issue of administration. That was a very tough one. It was strictly a compromise. I think both agencies, Senator Riegle, have done their best, but it simply is very difficult to have two precedents and it is proven in this case, and we have seen it, of course, in the litigations which have developed over the tax and the governance and fiduciary issues, and I think that I would want very much to add that to my list of what you ought to do about ERISA.

Thank you, Senator Riegle, for your kind words, and I am especially moved if I did have any influence on the newer Senators and Congressmen. It would add another note of gratitude to my having been here and in the House for all those years. Thank you very much.

The CHAIRMAN. Thank you, Senator Javits. We feel deeply honored that you came here today and that you have again expressed yourself on something that you have had such a great imprint on.

I think that you certainly have to go away from here with a feeling of esteem that each of us as colleagues has for you and for the privilege we feel it has been to have had you here.

Senator KENNEDY. Mr. Chairman?

The CHAIRMAN. Senator Kennedy?

Senator KENNEDY. Would it be possible to draw on the expertise of our good friend and distinguished colleague as we address this issue? I think we have gained immeasurably this morning putting this whole issue in some perspective and particularly understanding the historical context and also in evaluating a number of current recommendations that the Senator has about how to deal with this problem today.

This is a matter which this committee is going to be dealing with under the chairmanship of Senator Hatch, Senator Nickles, and others who have been interested in it as well as the Finance Committee.

If we felt, Senator Javits, that we could from time to time draw upon you as we face some difficult questions and to gain your insight into it, I think the Nation's workers and employers, their interests would be vastly enhanced.

I would ask that intercession as we go along.

Senator JAVITS. Senator, it would be my honor and my pleasure and no formal link is necessary so long as I am alive, I am at your service and that of every member of the committee and the chairman.

The CHAIRMAN. Thank you, Senator Kennedy, for that excellent suggestion, and thank you for your willingness to serve this committee. Since you left, a number of people have surmised that perhaps the Republican side has gone down in intellectual depth, at least Senator Kennedy has suggested that to me on a number of occasions. [Laughter.] However, you can imagine what has happened to the Democratic side without your influence as well. [Laughter.]

We really love, honor and revere you, Senator Javits. I think you know that, and for those of us who came here later in your career, when you were at the height of your intellectual prowess and influence in the Senate, I just want to say personally that it has meant a great deal to me to serve with you on this committee and in other ways in the Senate and even though we have differed from time to time, you always took time with me as a young Senator to help me to, perhaps, do a little bit better, and that meant a lot to me, and I am sure it has to all of our colleagues.

We will recess to come down and say hello and then we will go to our next witness.

The CHAIRMAN. We are very happy to have before the committee at this time Mr. Robert R. Midkiff, who is president of the American Trust Company of Hawaii, Inc., of Honolulu, Hawaii. He is the immediate past chairman of the Profit Sharing Research Foundation. He is a director of Profit Sharing Council of America; a director of the Small Business Council of America. He is a member of the ERISA Amendments Committee of the Association of Private Pension Welfare Plans; member of the Legislative Advisory Board of the ESOP Association.

We are very happy to have you with us, Mr. Midkiff. I am very happy to welcome you before the committee and will be very interested in what you have to say before the committee.

We will turn to Senator Matsunaga at this time,

Senator MATSUNAGA. Thank you, Mr. Chairman, and I wish to thank you and Chairman Nickles for arranging the hearing and for the opportunity to hear Mr. Midkiff. I am especially grateful because Bob Midkiff was instrumental to a large degree in my being in the Senate. He happens to be the permanent secretary of my campaign committee.

The CHAIRMAN. I will not hold that against you. [Laughter.] We are really happy to have you here.

Senator MATSUNAGA. Mr. Midkiff has been a true leader in the area of retirement and benefits. As president of American Trust in Honolulu, he oversees more than 2,000 qualified corporate retirement plans with more than $500 million in assets, and as you have already noted, he heads many organizations concerned with retirement plans and profit-sharing plans.

I am truly happy to have Mr. Midkiff with us this morning.

The CHAIRMAN. Thank you. We will take your testimony at this time, Mr. Midkiff.

STATEMENT OF ROBERT R. MIDKIFF, PRESIDENT, AMERICAN TRUST CO. OF HAWAII, INC.

Mr. MIDKIFF. Thank you. I am here coincidentally to attend a conference of the Association of Private Pension and Welfare Plans, and I brought some audiovisual material. This is a picture of the three-legged stool which was described by the President's Retirement Commission. It shows the three legs as the private pensions leg, the social security leg and the private savings leg, and they are all crumbling.

I am here to support from the field the testimony of Senator Javits, of what has happened recently as a result of TEFRA. We are concerned that there is not a real understanding of the enormous contribution of the private pension system to the millions of workers who depend upon these programs for retirement security.

About 74 percent of employees over 25 in full-time jobs other than agriculture are covered by private employer pension plans according to the 1980 census. This figure has continued to grow until recently.

I also wonder, and this is incredible to long-term students of the retirement income problem, if there is adequate understanding of what could be the long-term consequences of misguided efforts to seek tax revenues from the privately financed retirement plans without considering the consequences in terms of long-term national policy and impact upon many millions of beneficiaries of the system.

While shoring up the social security leg, the Senate Finance Committee, in effect, shortened both the private retirement leg and the individual savings leg of the three-legged stool.

Personal savings in the form of deferred compensation and income deferred through a cash or deferred option of profit-sharing plans are now included in the social security wage base.

I have just finished my term as chairman of the Profit Sharing Research Foundation, and we came up with the same figures that Senator Javits did. In 1981, there were 80,000 new plans and almost 700,000 total plans.

The complicated and punitive provisions of TEFRA will cause a tremendous decrease in the number of qualified plans, and we are going to see a record number of terminations.

During the first 3 months of 1982, American Trust Co. accepted 44 new corporate retirement plans and saw five terminations. For the same 3 months of 1983, when the prospective restrictions of TEFRA were beginning to be understood by our clients, new corporate plans accepted dropped by 50 percent to 22 and terminations increased 160 percent to 13.

One of the leading pension lawyers in Hawaii has qualified over 1,600 retirement plans. In the first three months of 1982, he installed 43 plans and terminated three plans. For the same 3 months in 1983, the ratio turned around. He installed only five plans and terminated 39 plans.

One of my fellow directors of the Small Business Council of America has estimated that 50 percent of the small business plans in the State of Florida will be terminated as a result of TEFRA. This is very bad news.

The CHAIRMAN. Senator Javits did not have too good of an opinion of TEFRA either.

Mr. MIDKIFF. Yes.

The CHAIRMAN. The more I sit around here the less esteem I hold of it. I really think it was, in large measure, a pretty bad tax bill.

Mr. MIDKIFF. It was legislation without input.

The CHAIRMAN. Right.

Mr. MIDKIFF. TEFRA is not entirely to blame. For example, the real estate recession caused termination of the plans of many of our real estate clients, but TEFRA was the final push that brought down many of these plans.

The principal concern of retirement advisers has been the new and punitive rules for smaller corporate plans. TEFRA for the first time drew a line between the plans of larger corporations and those of small business.

In Hawaii, for example, the 1980 census demonstrated there are only 350 companies with more than 100 employees and 14,000 with less than 100 employees.

We have an analysis of the pension plans of these companies put out by ERISA Benefit Funds, Inc., which showed that there were 4,258 qualified retirement plans in Hawaii, only 239 of these covered the larger companies but 4,000 cover firms with under 100 employees.

As we examine these plans, we find that 90 percent of those with under 100 employees will be classified as top heavy plans. Now, every single qualified retirement plan in the country, 700,000 plans, will be mandatorily required to be amended effective with the fiscal year beginning after December 31, 1983. The amendment process averages $1,000 for a defined contribution plan and $2,000 for a defined benefit plan. You have the attorney, the accountant and the actuary to deal with.

I figure that to be a billion dollars of expenses which will be deducted, way offsetting the proposed revenue increase that the authors of TEFRA thought they were going to raise for the Government.

Every plan that is not terminated will have to be tested annually to see if it is within the top heavy regulations, and that will be an additional item of administrative expense.

The newer limitations on funding for contributions have already caused one defined benefit plan to be terminated with frozen benefits for plan members. This plan covered five professionals and a staff of 20. Vesting was 20 percent per year with full vesting after 5 years of service. That is faster vesting than is in the TEFRA requirements.

One of the nonprofessional staff earning $19,000 per year and with a projected plan retirement benefit of $9,000 received a $3,000 accrued vested benefit, one-time, lump sum amount in her account. Another nonprofessional received $5,500 instead of $16,000 per year for life because of the termination of this plan.

The stockholders elected to continue the 15 percent money purchase pension plan, a defined contribution plan, but the staff has lost benefits that were costing the company 20 percent of compensation annually.

The true casualties of TEFRA are not the highly compensated, who will find other forms of tax shelter, but their rank and file employees. This is a small business problem we are talking about.

For another example, the 30-year old profit-sharing plan of a bakery supply firm with 43 employees owned by a father and two sons—I started that profit-sharing plan; he was a very good friend of mine—will become a top heavy plan. One of the sons died in 1982. His substantial vested account was distributed to his widow.

Under the proposed top heavy IRS regulations, amounts distributed within the last 5 years must be added back to determine whether 60 percent of all plan benefits belong to key employees.

The death benefit, which was paid out before TEFRA was passed, makes this a top heavy plan. That means that the father who is over 72 must start receiving pension benefits from his profit-sharing plan even though he had no intention of receiving them at this time.

I know he is going to terminate that plan even though it has built up $60,000 balances for each of the people who were with him when he started the company. The plan always provided eligibility after 1 month of service and graduated vesting over 7 years of service. This man's sense of fair play and equity has been outraged.

Not only do the top heavy plan rules treat small plans unfairly, the terrifying provisions of section 269(a) allow a revenue agent to come into your company and arbitrarily reallocate the earned income of an incorporated professional as though he were still unincoroprated.

An individual often establishes his own corporate retirement plan to follow his own personal investments, which may differ from those of his associates. Section 269(a), on top of the top heavy rules, is like wearing a pair of suspenders with a belt.

The TEFRA loan limits were totaly unexpected and ill-considered. They have created great hardship among plan participants. We at American Trust Co., administer 3,000 plan loans to plan members with a total value of $80 million as investments of our 2,000 corporate retirement plans. The average plan loan is $26,000, but there are more than 300 participants faced with refinancing their loan down to the TEFRA limit at the time the loan matures.

These loans were made for legitimate purposes such as the downpayment on the purchase of a home, college education for children or a severe financial emergency. Since the average price of a home in Hawaii exceeds $160,000, plan loans have been an extremely helpful way of increasing personal wealth through homeownership.

The plans have benefited from a fixed, competitive loan yield with cash flow through amortization of the note. Plans have earned more from the interest of these loans than the return from equities over the last 10 years.

Without hearings as to the nature of the abuse which was supposed to have been created by these loans, TEFRA severely restricted them.

The creators of ERISA, Senator Javits and Senator Williams, spent years formulating policy to preserve and foster the private pension system. They have carved out duel responsibility for supervision of the system. The Senate and House Labor Committees and the Department of Labor have the responsibility to protect plan participants and to set policy for human welfare and retirement security. The Finance and the Ways and Means Committee are responsible for providing needed tax revenues to meet Uncle Sam's ever increasing appropriations.

The alliance between the majority members of the Senate Finance Committee and the House Ways and Means Committee, supported by one joint staff, has resulted in hasty pension legislation. The final version of TEFRA included provisions that originated in the conference committee without prior hearing or consultation by either the Senate or the House.

We must restore a consistent congressional policy to promote and encourage retirement security for private sector employees in the United States. The incentives provided by past Congresses encouraged the creation of 700,000 retirement plans. ERISA codified reasonable conditions for nondiscriminatory operations and was passed after lengthy hearings and public input to both the Labor and the Tax Committees.

The public has demanded repeal of withholding on interest and dividends. Our 2,000 retirement plans request the Senator Labor Committee to review the harsh provisions of TEFRA that cruelly jeopardize the retirement security for the employees of small business.

I think that the overwhelming majority of the American public would agree with the chairman of this committee that in dealing with this sensitive subject of retirement security, we should know what we are doing at the time we are doing it.

Let us not undermine and weaken the private pension leg of the three-legged stool unless we understand the consequences and are prepared to face them.

Aloha.

[The prepared statement of Mr. Midkiff follows:]

Statement of Robert R. Midkiff,

President

American Trust Co. of Hawaii, Inc.
Honolulu, Hawaii

Immediate Past Chairman, Profit Sharing Research Foundation

Director, Profit Sharing Council of America

Director, Small Business Council of America

Member, ERISA Amendments Committee, Association of
Private Pension Welfare Plans

Legislative Advisory Board, The ESOP Association

At hearings on the effect of the
Tax Equity and Fiscal Responsibility Act of 1982
On the Private Pension System
Before the Senate Labor Sub-committee,
Senate Labor and Human Resources Committee

United States Senate, Washington D. C.

May 24, 1983.

Mr. Midkiff has been involved in the formation and trusteeship of qualified retirement plans since 1953. His firm is custodial trustee for over 2,000 qualified corporate retirement plans with over $500 million in plan assets.

The President's Commission on Pension Policy pictured a three-legged stool to support individual retirement security. The three supports were Social Security, the private pension and profit sharing system, and individual savings. Programs to strengthen each of the legs were proposed.

The strong leg, as we know, has been the private pension system which took a mighty blow from the Tax Equity & Fiscal Responsibility Act of 1982. The maximum amounts contributable to profit sharing and money purchase pension plans and maximum benefits provided by defined benefit pension plans were cut back below the amounts (adjusted for inflation) deemed reasonable when ERISA was passed in 1974.

We are concerned whether there is real understanding of the enormous contribution of the private pension system to the millions of workers who depend upon these programs for their retirement security.

About 74% of all employees over 25 years of age in full time jobs (other than agriculture) are covered by private employer pension plans, according to the 1980 census. This figure has continued to grow until recently. What's more, for many of these people, their private pensions will constitute the largest portion of their retirement income--larger than the amount social security will provide.

I also wonder--and this is incredible to long-time students of the retirement income problem--if there is adequate understanding of what could be the long-term consequences of misguided efforts to seek tax revenues from the privately financed retirement plans without considering the consequences in terms of long-term national policy and impact upon many millions of beneficiaries of the private retirement systems. It will be intolerable if we divert funds from private pension plans and reduce their future benefit payments to meet the current revenue needs of the federal government. It would simply replace one need by creating an even bigger one.

While shoring up the Social Security leg, the Senate Finance Committee in effect shortened both the private retirement leg and individual savings legs of the 3-legged stool. Personal savings in the form of deferred compensation, salary deferred under Code Section 403(b) in the form of an annuity, and income deferred through the cash or deferred option of a profit sharing plan are now included in the Social Security wage base and subject to the Social Security tax.

The Profit Sharing Research Foundation, of which I am the immediate past chairman, estimates there were 379,000 qualified defined benefit and money purchase pension plans and 315,000 qualified profit sharing and stock bonus plan on December 31, 1981. In 1981 alone, 80,000 new plans were qualified.

The complicated and punitive provisions of TEFRA will cause a tremendous decrease in the number of qualified plans. By the end of 1983, I believe, we will begin to see a record number of terminations, rather than a record number of new starts of qualified plans.

During the first three months of 1982, American Trust Company of Hawaii accepted 44 new corporate qualified retirement plans and saw five terminations. For the same three months of 1983, when the prospective restrictions of TEFRA were beginning to be understood by our clients, new corporate plans accepted dropped by 50% to 22 and terminations increased by 160% to 13.

One of the leading pension lawyers in Hawaii has qualified over 1,600 retirement plans. In the first three months of 1982, he installed 43 plans and terminated three plans. For the same three months in 1983, the ratio turned around. He installed only five plans and terminated 39 plans.

TEFRA is not entirely to blame. The real estate recession, for example, caused the termination of the plans of many of our real estate clients. But TEFRA was the final push that brought down many of these plans.

The principal concern of retirement advisors has been the new and punitive rules for smaller corporate plans. TEFRA for the first time draws a line between the plans of the larger corporations and those of small business.

In Hawaii, for example, the 1980 census demonstrated there were only 350 companies with more than 100 employees. By contrast, there were 14,400 corporations with less than 100 employees.

The Financial Directory of Pension Funds for 1982-1983 published by ERISA Benefit Funds, Inc. analyzes the Form 5500 reports filed by Hawaii employers for the Department of Labor. 4,258 qualified retirement plans in Hawaii were listed in this report. 239 covered more than 100 employees and 4,019 plans covered companies with under 100 employees.

Analyzing the Form 5500C reports prepared by American Trust as agent indicates that 90% of plans with under 100 employees will be classified as "Top Heavy" plans. Beginning with the fiscal year after December 31, 1983 every single plan will have to be amended to provide accelerated vesting and minimum contributions for employees. The amendment process averages $1,000 per defined contribution plan and $2,000 per defined benefit plan; this can be another reason for terminations. Those not terminated will have to be tested annually to see if the top heavy provisions still apply.

The new limitations on funding for contributions have already caused one defined benefit plan to be terminated with frozen benefits for plan members. This plan covered five professionals and 20 staff. Vesting was 20% per year with full vesting after five years of service; faster vesting than the new TEFRA requirements.

One of the nonprofessional staff earning $19,000 per year and with projected plan retirement benefits of $9,000 per year received a $3,000 credit as her present actuarial value. Another nonprofessional received $5,500 present value instead of $16,000 per year as a retirement benefit.

The stockholders elected to continue the 15% per year money purchase pension plan contributions, but the staff have lost benefits that were costing the company 20% of compensation annually. The true casualties of TEFRA are not the highly compensated, who will find other forms of tax shelter, but their rank and file employees.

For another example, the 30-year old profit sharing plan of a bakery supply firm with 43 employees owned by a father and his two sons, will become a "Top Heavy" plan. One of the sons died in 1982. His substantial vested account was distributed to his widow. Under the proposed "Top Heavy" IRS Regulations, amounts distributed within the last five years must be added back to determine whether 60% of all plan benefits belong to key employees. The death benefit will be enough to turn this nondiscriminatory plan into a top heavy plan.

From personal conversations, I know the father, president of this company, plans to terminate the profit sharing plan which has built up retirement accounts of over $60,000 for every one of the initial employees. The plan has always provided eligibility after one month of service and graduated vesting during seven years of service. This man's sense of fair play and equity has been outraged.

Not only do the "Top Heavy" plan rules treat small plans unfairly, the terrifying provisions of Section 269(a) of TEFRA allow a Revenue Agent to arbitrarily reallocate the earned income of an incorporated professional as though he was still unincorporated. An individual often establishes his own corporate retirement plan to follow his own personal investment objectives. These may differ substantially from those of his partners. Section 269(a), on top of the Top Heavy rules, is like wearing a pair of suspenders with a belt.

The TEFRA loan limits were totally unexpected and ill-considered. They have created great hardship among plan participants. We at American Trust Company administer 3,000 plan loans with total value over $80 million as investments of our 2,000 plans. The average plan loan is $26,000, but there are more than 300 participants faced with refinancing their loan down to the TEFRA limits at the time the loan matures.

These loans were made for legitimate purposes such as the down payment on the purchase of a home, college education for children, or a severe financial emergency. Since the average price of a home in Hawaii exceeds $160,000, plan loans have been an extremely helpful way of increasing personal wealth through home ownership.

The plans have benefitted from a fixed, competitive loan yield with cash flow through amortization of the note. Plans have earned more from the interest on these loans than the return from equities over the last ten years.

Without hearings as to the nature of the abuse which was supposed to have been created by these loans, TEFRA severely restricted them.

The creators of ERISA spent years formulating policy to preserve and foster the private pension system. They carved out dual responsibility for supervision of the private pension system. The Senate and House Labor Committees and the Department of Labor have the responsibility to protect plan participants and to set policy for human welfare and retirement security. The Finance and Ways and Means Committees are responsible for providing needed tax revenues to meet Uncle Sam's ever increasing appropriations.

The alliance between the majority members of the Senate Finance Committee and the House Ways and Means Committee.

supported by one joint staff, has resulted in hasty pension legislation. The final version of TEFRA included provisions that originated in the conference committee without prior hearings or consideration by either the Senate or the House.

We must restore a consistent Congressional policy to promote and encourage retirement security for private-sector employees in the United States. The incentives provided by past Congresses encouraged the creation of over 700,000 retirement plans. ERISA codified reasonable conditions for nondiscriminatory operations and was passed after lengthy hearings and public input to both the Labor and the Tax Committees.

The public has demanded the repeal of withholding on interest and dividends. I represent over 2,000 retirement plan clients who request Senate Labor Committee review of the harsh provisions of TEFRA that cruelly jeopardize the retirement security for the employees of small business.

Aloha,

Robert R. Midkiff

The **Chairman**. Thank you so much, Mr. Midkiff. We appreciate having you here and having this testimony here today.

Senator Matsunaga.

Senator **Matsunaga**. Thank you very much, Mr. Chairman; and, knowing your busy schedule, I do appreciate your remaining here to listen to the testimony of Mr. Midkiff.

I certainly appreciate your statement, Bob, in the light of what has occurred since TEFRA was passed. As you so ably pointed out, TEFRA was enacted without hearings, and being a member of the Finance Committee, I know how it was rushed through that committee primarily with the intent of raising revenues and reducing costs and in an effort to balance the budget.

As you know, I have been a strong advocate of profit-sharing plans. What has been the impact of TEFRA pension provisions on profit-sharing plans?

Mr. **Midkiff**. Profit sharing, as a defined contribution plan, is less affected than the defined benefit plans, but you have the example of the top heavy situation. Almost every plan that we have in Hawaii is a top heavy plan now, and so we have the restrictions on compensation and we have the faster vesting. Almost invariably, you will find now eligibility for plans will go to 3 years because the vesting starts after 3 years. It will be like the old Keogh plan rules.

So we will not have 90-day waiting periods or a 1-year waiting period for eligibility. It will have to go to 3 years because that is when the vesting takes place. That is the way changes will be made.

You have the required payout to the key employees. You will need a separate set of records to show what happened before TEFRA and what happened after TEFRA at an additional cost, and you have the penalty provisions in case of payouts. So that all will affect profit sharing.

Profit sharing has been the way that most people start retirement plans. It is marvelous for younger people because they build up large benefits, as I indicated in my bakery supply company example. example.

Defined benefit plans are for the older people who do not have a number of years left to build up benefits in their plan.

Senator **Matsunaga**. As a director of the Small Business Council of America, you are well versed with the effect of TEFRA on small businesses. I think a prime concern of the Congress should be the health of small businesses.

What has been the impact of TEFRA's top heavy rules on small businesses?

Mr. **Midkiff**. The average employer of a small business, the man who started the company, the man that is making it work is looking at costs. He is trying to survive out there. He has to consider what the benefits are versus the costs.

He has the feeling that he has earned this money with the help of his employees, and he has a choice on what he wants to do with the money. He can incorporate as a "small business company" and take income without any income tax at the corporate level. He can stay as a corporation and reinvest corporate earnings in various forms of corporate investment or he can contribute to a retirement plan, and he has to evaluate that.

He is reducing his own income when he puts it in a retirement plan for his own employees. So he has to evaluate how much it is worth.

The mandatory minimum contribution requirements, I do not think are a problem. Most employers are delighted to contribute the minimum requirements of TEFRA. The problem is the new restrictions on benefits. When you say that the boss can only retire on a certain percentage of his income, he is not going to put in a higher percentage of compensation or buy a higher benefit for his lower income people.

So it will have a more serious impact on small plans than on the larger plans.

Senator MATSUNAGA. The Senate Finance Committee, of which I am a member, is looking into extending IRA deduction limits at the expense of corporate deductions. How would such a change affect private plans, in your opinion?

Mr. MIDKIFF. I have an actual case to show you what will happen as a result of that. One of my more successful retirement plans a profit sharing plan, bootstrapped itself, prior to TEFRA, investing in the land and building upon which it is located. The plan bought the land. The company bought the building.

The land has appreciated, according to an independent appraisal each year, by 15 percent since 1972. The employees who used the plan provision to make voluntary investments in the plan discovered that they could invest voluntarily and withdraw their funds voluntarily but the earnings and appreciation would stay in the plan, and they could therefore earn 15 percent tax free.

There are 180 seamstresses and designers and marketing people in this garment manufacturing company; 130 of them were contributing 10 percent of their compensation, voluntarily investing in the plan.

Early this year, I went out to explain to the employees how wonderful a qualified deductible employee contribution would be where they could deduct $2,000 out of what they were putting into the plan already.

But I explained that they would have to pay a penalty if they ever wanted to withdraw it. These ladies decided that the penalty was too much, that they would prefer to keep the voluntary amount nondeductible so that they could withdraw it if they needed it for the education of their children or improvement to their house.

I do not think the IRA will take the place of the qualified employer contribution to retirement plan.

Senator MATSUNAGA. One final question. When the TEFRA pension provisions were passed in 1982, it was estimated that a substantial increase in Federal revenue would result. What do you believe will be the revenue impact of TEFRA changes?

Mr. MIDKIFF. Well, the estimates of the joint committee staff showed an $800 million increase because of the reduction in the maximum amounts contributable. As I pointed out in my testimony, there is a billion dollars of deductible expense for attorneys and accountants and actuaries to amend these plans with the mandatory amendment requirement. The Federal Government will lose money as a result of these amendment, rather than gain money.

Senator MATSUNAGA. No further questions.

The CHAIRMAN. Thank you, Senator Matsunaga.

We thank you, Mr. Midkiff for being with us today. We wlll keep the record open so that if there are any other questions of you as they read your statement, they can submit them in writing, members of the committee. We will keep it open for members of the full committee.

We will recess these hearings until further notice.

[Whereupon, at 11 a.m., the subcommittee adjourned at the call of the Chair.]

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